# Loyalty: The Translation of Information into Value?

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Assignment submitted in partial fulfillment of the requirements for the degree of Master of Philosophy (Information and Knowledge Management) at the University of Stellenbosch, South Africa

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December 2005

## Declaration

I, the undersigned, hereby declare that the work contained in this assignment is my own original work and that I have not previously in its entirety or in part submitted it at any university for a degree.

Signature: ........................................................ Date: 17 October 2005

## ABSTRACT

Loyalty programmes have become very popular over the last 10 years and many businesses have chosen to implement such programmes to support their marketing strategies. Fundamental to the functioning and success of such loyalty programmes is the ability to gather, process, analyse and apply information regarding a business' customers. Such information is generated through customers' interactions with the programme and the business to which it is linked, as well as the various services and their providers that make up the programme. The aim of this research project is to investigate the question of whether an information-oriented strategy, based on the principles and paradigm of loyalty manifest in the global phenomenon of loyalty programmes, can deliver value to a business adopting them.

In the process of the investigation, the primacy of information as the source of value for any business in the new economy will be discussed. This will be transposed onto the argument that the customer is the source of revenue generation and drives the flow of value in a business system. The results of these two streams of argument will show how the synergy between customers and their information, through the lens of loyalty economics, can be translated into business value with the achievement of core business objectives, i.e. sustainable revenue, growth, profit and competitive advantage. Evidence of these contentions will be provided by presenting and analysing local and international loyalty programmes as case studies manifesting this approach.

In conclusion, the various findings of the research will be synthesised in the context of existing, sound business, customer, and information and knowledge management theory to derive an information oriented model of loyalty. This model is intended to be a strategic framework which a business can apply to provide insight into their decision making and assist in the achievement of their objectives.

In further research beyond the limits of this paper, the model is intended to be tested. In application, the validated model's purpose will be to introduce to businesses and their leadership the paradigm of loyalty as a strategic tool. Furthermore, the model could be used as a foundation to assist in the creation, evaluation and development of loyalty programmes and their business implications in practice.

## OPSOMMING

In die afgelope 10 jaar het lojaliteitsprogramme baie populêr geword en baie besighede het verkies om sulke programme te implementeer om sodoende hulle bemarkingsstrategieë te ondersteun. Die grondslag vir die funksionering en sukses van sulke lojaliteitsprogramme is die vermoë om informasie oor klante te versamel, te verwerk, te ontleed en toe te pas. Sulke informasie word gegenereer deur die klante se interaksie met die programme en die besigheid waaraan die program verbind is, asook die verskeie dienste en diensverskaffers waaruit die programme bestaan. Die doel van hierdie navorsingsprojek is om ondersoek in te stel na die vraag of 'n informasie georiënteerde benadering, gegrond op die basis van lojaliteit, gemanifesteer in die wêreldwye verskynsel van lojaliteitsprogramme, waarde kan toevoeg vir besighede wat hulle aanneem.

Die belang van informasie as die bron van waarde vir enige besigheid in die nuwe ekonomie sal as deel van die ondersoek bespreek word. Dit sal saamgevat word in die argument dat die klant die bron is van inkomstegenerasie en dat die klant die vloei van waarde in 'n besigheidsisteem dryf. Die resultate van hierdie twee argumentlyne sal aantoon hoe die sinergie tussen die klante en hulle informasie, deur die lens van lojaliteitsekonomie, bydra to besigheidswaarde deur die bereiking

van kern besigheidsdoelwitte, bv. volhoubare inkomste, groei, wins en mededingende voordeel. Bewyse van hierdie stellings sal verskaf word deur plaaslike en internasionale lojaliteits programme te beskryf en ontleed as gevallestudies wat hierdie benadering weerspieël.

Ten slotte sal die verskillende bevindings van die navorsing saamgevat word in die konteks van bestaande, goeie besigheids-, klante- en informasie en kennisbestuur ten einde 'n informasie geöriënteerde lojaliteitsmodel te skep. Hierdie model se doel is om 'n strategiese raamwerk te skep wat 'n besigheid kan toepas om insig te gee in strategiese besluite en om doelwitte te bereik.

In verdere ondersoek buite die bestek van hierdie werkstuk sal die model getoets word. In toepassing is die gevalideerde model se doel om besighede en hulle leiers bekend te stel aan die paradigma van lojaliteit as 'n strategiese hulpmiddel. Verder kan die model gebruik word as grondslag vir die skepping, evaluering en uitbreiding van lojaliteitsprogramme en hulle besigheidsimplikasies in die praktyk.

## Dedication

This paper is dedicated to my Father.


## Acknowledgements

I would like to thank my trusted advisors, friends and mentors over the years for their inspiration and support in my life and the completion of this project.

Special thanks are due to:

Mr. Peter Habberton

Mr. Quinton van Eeden

Mr. Evert Botha

Dr. Martin van der Walt

Mr. Daan Botha

Ms. Sarahann Doherty

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## List of Abbreviations

| | | |
|---|---|---|
| CI | - | Competitive Intelligence |
| CHOC | - | Children's Haematology Oncology Clinics |
| CRM | - | Customer Relationship Management |
| ECT | - | Electronic Communications and Transactions |
| ICT | - | Information and Communications Technology |
| IKM | - | Information and Knowledge Management |
| IM | - | Information Management |
| IO | - | Information Orientation |
| IR | - | Information Resourcing |
| IS | - | Information Systems |
| IT | - | Information Technology |
| IVR | - | Interactive Voice Response |
| LTV | - | Lifetime Value (of the Customer) |
| NPV | - | Net Present Value |
| POS | - | Point of Sale |
| POWA | - | People Opposing Woman Abuse |
| ROC | - | Return on Customer |
| ROI | - | Return on Investment |
| SA | - | South Africa |
| SMS | - | Short Messaging Service |
| TPF | - | Tesco Personal Finance |
| USA | - | United States of America |

# CHAPTER 1: INTRODUCTION

## 1.1 Background

Over the past 10 years, there has been a proliferation of what have become known as 'loyalty programmes' in a wide range of industry sectors in the South African environment (Conradie, 2002 – 2005). In effect, the conceptualisation, design, implementation and management of loyalty programmes have become a recognised aspect of specialised marketing in practice. At their core, loyalty programmes are intricate, multi-dimensional business systems that are focused on the optimisation of customer relationships. Well known examples of such programmes, their brand source and associated industrial sectors are:

- South African Airways **Voyager** - Airlines
- FirstRand **eBucks** - Financial Services
- Discovery **Vitality** - Medical & Life Insurance
- Clicks **Clubcard** - Lifestyle and Pharmaceutical Retail
- Dis-Chem **Benefits** - Pharmaceutical Retail

The foundation of all these programmes is a customer orientated view of each business which acknowledges the primacy of the customer to achieve core objectives through a strategic approach to customer loyalty. In addition to the fundamental marketing objectives of acquisition, retention and satisfaction of the customer, these programmes are to some extent aimed at securing a customer's life long value to their business. In this paradigm, the customer not only offers the business value in terms of price paid for goods and services and frequency of purchase, but further value in terms of the information that can be gathered, analysed and applied through their interactions with the business, its brand and its extended product offerings.

Coupled with this strategic mindset, these programmes demand a level of personalisation in order to identify, track and reward appropriate and profitable customer behaviour thereby building and maintaining a mutually beneficial relationship between the business and the customer. Technological convergence over the last ten years now makes it possible to interact and gather detailed customer information on an unprecedented scale, offering a business insights into customer profiles, behaviour, buying patterns and trends that provide it with customer 'intelligence' at strategic, operational and functional levels.

## 1.2 Problem Statement and Focus

The question this paper intends to address is how the use of customer information provides insight into the creation of value, the economics of customer loyalty and the purpose of loyalty programmes. To respond to that primary question, it is necessary to identify and acknowledge the variety of factors that are involved in the understanding of firstly, the new economy, secondly, the economics of loyalty and finally, the current phenomenon of loyalty programmes in practice.

Through analysis of factors contained in these three streams of the argument, the research objective of this paper is to create an information based model of loyalty that aims to offer business a tool for translating information into value. The paper will take into account the context and the stakeholders as factors of the model, together with the processes and further resources and their capabilities required to derive a robust model, with particular reference to certain Information and Knowledge Management theory and practices. In application, this paper will furthermore reveal how loyalty programmes and the value to be derived from them, as phenomena of the new information and knowledge based economy, provide practical evidence of information and knowledge based commerce.

## 1.3 Preliminary Study

As opposed to the wealth of material studied in the IKM course on the aspects of the new economy and business therein, there are few academic papers that cover the market phenomenon of loyalty and loyalty programmes. Market demand and interest however, has elicited a number of books, articles and syndicated research which has been used as the core research material for this paper. A brief synopsis of the material supporting these streams of the paper's argument is detailed below.

### 1.3.1 Information and Knowledge Management

The theoretical context for the argument has been sourced from the prescribed and extended reading from the various modules of the M.Phil Information and Knowledge Management (IKM) programme. Core concepts of the new economy, its characteristics and strategic implications will be presented with reference to their original authors that include Choo, Marchand, Earl, Drucker, Castells and Skyrme. Their collective diagnoses and prescriptions that gave birth to the field of study contribute the necessary foundations on which to build a strong argument and a framework for new insights to be explored.

### 1.3.2 Loyalty Economics

A theory that provides a credible framework for the argument regarding the economics of loyalty is Frederick R. Reichheld's book, *The Loyalty Effect* (1996) which stands as the seminal work behind the principles of loyalty, loyalty 'economics' and their effect in application to a business system. Core to his theory is the concept of customer value, the economic effect of this value through focus on customer retention and the principles involved in securing the value through identifying the right customers, employees and investors.

His following work *Loyalty Rules* (2001) develops the concepts taken from *The Loyalty Effect* by identifying the power of partnerships within a business system with particular reference to companies and their leaders that ascribe to the principles of loyalty and the real economic effects of loyalty orientation for their businesses. Some of the case studies he draws from include US-based global brands such as Harley Davidson, Intuit and Dell. A supplementary reference to Reichheld's work is Arthur Middleton Hughes' book *The Customer Loyalty Solution* (2003) which offers a comparative insight into the principles and structure of platforms, technology and customer strategy and how loyalty solutions have evolved out of the field of database marketing together with case studies and client examples from experiences with businesses in the USA.

### 1.3.3 Loyalty Programmes

Bruce Conradie, a South African researcher, has published a number of papers on the subject of loyalty programmes. His various syndicated research papers consist of surveys and analyses of loyalty programmes and their derivatives in South Africa (2002, 2003, 2004 and 2005) and the United Kingdom (2004). His work offers theoretical value in its extensive profiling of a wide range of loyalty programmes, delineating the various concepts defining the field and the types of programmes themselves (loyalty programmes, reward programmes, customer clubs etc.) and providing the reader with an idea of the differences in the purpose, structure and effect of such programmes from a business and customer perspective.

Of particular concern in all his work is the tangible value that loyalty programmes offer the customer for their loyalty, and these findings offer key benchmarks for the case studies to be discussed in this paper. His work to date, although thorough, does not adequately analyse the underlying principles of customer loyalty, its information orientation, and how these are translated into the management of information systems, resources and technology supporting the business objectives behind 'loyalty programmes' – issues which will be addressed in this paper.

*Scoring Points* (Humby et al, 2003) is an in depth international reference, detailing the origin, initialisation, management, measurement and development of one of the largest loyalty programmes in the world with 11 million members – the Clubcard programme founded by the retailer Tesco based in the United Kingdom. It is a detailed case study into the business, customer and technological dimensions of loyalty programmes and it traces Clubcard's specific history from the mid-1990's to 2003. In this book, the power of customer data, data management, analysis and the application of these analyses to the business is held paramount.

## 1.4 Research Methodology and Design

Considering the exploratory, conceptual nature of this paper, the research design, as suggested by Ghauri et al (1995:27), relies on secondary and tertiary sources of data as evidence for the support of the claims and the argument of the paper. These sources (detailed in section 1.3) are intended to provide theoretical reliability with a comprehensive review of respective theory as a point of departure. Secondarily, quantitative inferences against concepts will be taken from a selection of local and international case studies and their measured performance in terms of common business objectives as far as possible.

The qualitative departure intends to synthesise the three streams of the argument within the context of business, customer and information theory in the networked economy. Once these foundations have been identified and justified, the existence of examples of loyalty programmes in practice will allow those derived concepts to be tested through analysing the performance of case studies against business performance thereby providing the ability to quantify concepts to measure the foundations of the intended model (Glazier & Powell, 1992:38). Measured successes will be deconstructed to confirm and validate the selection of the foundational concepts and the relationships between the various factors of loyalty, achievement of business objectives, customer information and the application of information to generate business value (Leedy et al, 2001:102).

To ensure validity of the claims and conclusions, case studies from both local and international markets will be evaluated and common features and performance will be derived through comparative analysis to ensure the external validity of these features as points for generalisation in the construction of the model (Ghauri, 1995:33). Special attention will be paid to substantiating the internal validity of those concepts against reliable and accepted business and information theory while being aware of the potential pitfalls of bias, blindspots and ill-defined conceptual foundations of key concepts and terms (Mouton, 1996:112).

## 1.5 Impact

From the analysis of the concepts, their contexts and the practical case studies, a conceptual framework will be filtered. The framework will present the common elements that provide a business with a model to identify the aspects of its business system it needs to focus on to track, manage and measure the customer relationship and their loyalty. In application, the model could act as a scientific tool of convergence between the business and its objectives, the customer and their needs, the market in which they interact, and the flows of information that bind them together.

# CHAPTER 2: THE NEW ECONOMY

## 2.1 Introduction

This chapter will contextualise the research problem with the discussion of the characteristics of the 'new' global networked economy. The primacy of information, knowledge, the convergence of information, communication, computation and technology and the specific factors influencing this new economy will be introduced to delineate core concepts.

For clarity, Lipsey et al (1990:960) defines 'economy' as:

*"...a set of interrelated production and consumption activities..."*

In the new economy the resources prevalent in production have changed in substance and structure as information and knowledge have been identified as key resources in the production process. The recognition of these new resources has effectively fuelled the shift from an industrial to a 'new' knowledge based, information orientated economy in the last century.

Why are information and knowledge key resources of the 'new' economy? Information and knowledge have always been integral parts of the activities of production and consumption. In terms of production, information and knowledge have always been necessary components of all human economy. The processes of business would not take place without the necessary information, and the knowledge to apply that information to the identification of opportunities, sourcing of resources, the processing of those resources into outputs or products and the exchange of those products with those who consume them (customers). The answer to the question posed above lies in the nature of information and knowledge.

## 2.2 The Nature of Information and Knowledge

Traditional economic theory states that resources are scarce and limited in relation to the satisfaction of unlimited human needs and desires (Lipsey, 1990:4). Two resources, largely ignored, are not limited – information and knowledge. Knowledge, since the beginning of time, has been the catalyst for the growth and development of human understanding of the external environment and progress within it. From the birth of the oral tradition and the ability for human beings to communicate, to a literary and numeral system, information has been passed down to individuals and groups through the ages. Information has provided a critical resource to human beings wanting to make sense and decisions about their collective and individual past, present and future activity and the consequent development of their individual and collective knowledge bases (Skyrme, 1999:77).

The ever growing body of knowledge over time has necessitated the development of ways to manage and codify its foundation of information first manifested in the existence of manuscripts, books, libraries and more recently progressed into the proliferation of information 'technologies'. Examples of these technologies include networked hardware, software, databases, telecommunication mediums, platforms and devices, technologies that have become synonymous with what is known as the information age or the new 'knowledge' economy.

In terms of the economic processes of production and consumption, information is available to be derived from the external environment i.e. competitor activity, market conditions, new technologies and customer feedback; as well as from the internal environment i.e. production levels, resource requirements, sales and quality assurance (Lowe, 1999:2). Information pervades every aspect of the business system.

Information however, remains information until it is applied. The application of information through the processing of that information by the creativity of the human mind creates knowledge (Marchand, 1998:255). When information has meaning and knowledge can be applied to further information, an individual has the ability to make decisions, in relation to the information processed and knowledge gained. In so doing, knowledge provides the capacity to act with purpose and the capacity to innovate by applying knowledge in action and embedding that knowledge in processes, products and technology (Choo, 1998:45).

The ability of the human mind to process the unlimited resource of information into knowledge and the ability to produce unlimited amounts of new knowledge through the continuous application of information to existing knowledge bases is the realisation of the productivity of information. The 'new' knowledge economy is the manifestation of this realisation where the potential for innovating existing processes, products, technologies and people's thinking is real. In the knowledge economy, existing understandings of the business system are revised, refined and regenerated through the recognition of its nature, generating new knowledge in its application and development upon previous 'knowledges'.

## 2.3 The Knowledge Economy

The move from an agrarian economy to an industrial economy was made possible through the discovery and application of technology – embedded knowledge – into the process of production. In the 21st Century economy, the resources prevalent in production and consumption processes have changed in substance and structure as information and knowledge have been identified as key regenerative resources. This has fuelled the shift from an industrial to an informational or knowledge economy in the last fifty years.

The knowledge economy can be characterised by one unique defining feature from previous forms of economy – the primacy of the resource of knowledge (Drucker, 1994:45). The abundance of information and therefore the abundance of opportunities to create knowledge have redefined traditional economic theory. All resources can be reallocated, rearranged and reconstituted through the application of knowledge. Knowledge is the newly identified source of innovation in the modern era. This innovation is enabled by the technical understanding and the technological ability to manage the processing of information and the application of the knowledge present, developed and derived (Castells, 2000:17). Why have there been so many dramatic changes in what is relatively a short amount of time? There has been some debate as to what exactly is the primary cause of the move to a new paradigm in the theory and practice of business.

One perspective – the information processing paradigm – propounded by authors such as Choo, Marchand and Earl is that the proliferation of information technology (IT) in modern business in the last three decades has changed the focus and form of business and its relationship with information. Integrated information systems (IS) have enabled modern businesses to gather, organize, store, distribute, produce, use and apply information from and to all areas of their business. The influx, availability and application of this new information provides a business and its people with the tools to make better decisions, processes, products, services and ultimately profits. Information, in effect, has become the primary resource of business. External factors such as the free market economy, globalization and networking make the primacy of information even more critical. The ability to harness the power of appropriate information, at the right time, applied to the right place has become the threshold of competitive advantage.

Castells (2000:30) concurrently argues that the main driver behind the shift is the convergence and subsequent penetration of communication and information processing technologies into nearly all areas of human activity, particularly into the way humans 'do' business. The commercial application, availability, mass consumption and almost obsessive advancements made in the ICT environment have created a world where the traditional boundaries of human existence no longer apply. Digital satellite telecommunication, electronic commerce, mass media and the affordability of gaining access to the global information network through consumer based information and communication technology products such as personal computers, cellular phones, satellite television and the internet have unequivocally changed the frame of human experience.

No longer is human interaction and business activity dependent on time or place (Castells, 2000: 406/7). Inputs, processes and outputs can be sourced, changed and distributed anytime, anywhere. Skyrme (1999:20) calls this phenomenon 'virtualisation'. Information, the raw material of knowledge creation, now pervades every domain of human activity and is instantly available through the multiplicity and accessibility of communication channels offering levels of collaboration between humans and their businesses never possible before (Leibold et al, 2002:16). It is through this collaboration, the sharing of knowledge through the accessibility of information, and its product of further knowledge, that has led to this new definition of the ever changing complexities of the 'knowledge' economy.

Competitive advantage in this new environment is determined not only by what you know now, but more importantly, how you will react and adapt to things you did not know before; how and where you get to know about those things you did not know; how you get to know more and sooner about those things than your competitors; and how creatively you can apply and protect the things you know (Zack, 1999:134). Where the imperative of any business is ultimately to remain sustainable through protecting and enhancing competitive advantage, knowledge is the competitive differentiator in this new dynamic economy and therefore demands specific attention as an element of business strategy, the topic of Chapter 3. Prior to that discussion, the factors influencing the new economy will be discussed.

Major shifts in the economy of the industrial age against what Earl describes as the 'information age' are illustrated in table 1.1 below, presenting primary economic components and activities of each age and how they have changed (2000:16):

| **Industrial Age** | | | | **Information Age** |
|---|---|---|---|---|
| *From* | | | | *To* |
| Marketplace | → | Doing business | → | Marketspace |
| Hierarchies | → | Organising Business | → | Networks |
| Scarce Physical Resources | → | Economics in Business | → | Limitless Digital Resources |
| Machine/Craft Workers | → | Populating Business | → | Knowledge/Intellect Workers |
| Real Estate and Plant | → | Infrastructure in business | → | Information Technology |

Source: Earl, 2000:17

**Table 2.1: The Movement to the Information Age**

In summary, the recognition of information and knowledge has redefined the way business is done and how a business will have to approach their internal and external environments in the new economy. The usage and management of information from these environments becomes the key to achieving competitive advantage in the new economy. Influencing factors requiring further attention include the demands of the users of that information; the technology facilitating the flows between users; the processes and procedures governing the technology and users; the specific conditions relevant to the users themselves; and the structured orientation of these factors around information itself.

## 2.4 Information Technology

The creation of effective, productive knowledge is dependent on the efficient management of information in relation to the demands of its users. The users of information and creators of knowledge are human. Whether constituted as individuals or groups, the human resource has become the crucial resource determining the productivity of business in the new economy – the knowledge worker and the knowledgeable customer (Drucker, 1994:6). Developments in technology now provide these knowledge resources with the capability to collect, manage, store and distribute information and maximise knowledge creation. This need, coupled with the proliferation of new discoveries in technology to mobilise information were determining factors driving the recent, rampant revolution of information technology.

Historically, the study of skill, the ability to do – *techne* in Greek – gave birth to technology (Drucker, 1994:27). The study of skill involves the codification and processing of information and the application of that information onto the function of doing, which results in knowledge being generated. Technology, as a material input of the production process, is the tangible product of knowledge from the processing of information. Information and technology therefore, are synonymous and mutually dependant on each other. From the creation of the printing press, to the proliferation of literacy and learning, to the application of learning on the process and product of work, technology has developed as a result of the function of doing; at the same time, the function of doing has developed as a result of technology.

'Information' technology as it is manifested today has developed out of the recognized need to gather, store and process information for a variety of different purposes. One of its most productive applications and purposes is as the enabler to knowledge generation – knowledge that could stimulate innovation.

The technological ability to compute information in a mechanical way through a digital platform has existed since the 1950's. The invention of the 'computer' applied to business production, performed the function of processing accounting, transactional, textual and numerical information. The development of IT over the next fifty years progressed from information retrieval and storage systems such as databases and document management to the creation of information dissemination (communication) mediums such as email and internet through the advent of networking (Skyrme, 1999:28). In the 21st Century, IT has started to move beyond the boundaries of information processing to areas of integrating information into sets of relationships – supply and operations (Enterprise Resource Planning), sales (Sales Force Automation) and customers (Customer Relationship Management). These developments in the functionality of IT and the complexities which they are able to accommodate, allow the processing of information found from, within and through production and consumption processes to assist its users – knowledge workers.

IT does not generate knowledge as a function of itself. Knowledge is generated by the application of information, processed by IT, by human intellect. IT therefore, merely enables the process of knowledge generation by providing the ability to process information. The realisation of the potential effect of IT is dependent on direct or indirect human interaction. For IT to be applicable and have purpose in the new economy, specific consideration needs to be given to the human factors that will impact its design, implementation and efficacy.

**2.5 Human Factors**

Technology is, by its nature and historical impact, an agent of change. Human factors, such as people, their behaviours and values are by nature change averse. The behaviour patterns of humans – knowledge and service workers – are far more difficult to re-programme than any IT system. Integrating a new technology potentially requires its intended users to adopt a new mode of behaviour which requires adequate understanding of the users themselves and thereafter, time and progressive, consistent training. An interesting point made by Kaplan and Aronoff (1996:7) is the importance of the work setting in the knowledge economy. The ergonomics of the working environment – desktop computers, electronic noise, highly reflective screens, cubicles, posture etc. – can greatly affect the ability of knowledge workers to process information and produce knowledge. Where the users environment is affected by changes in (in this case) technology, specific attention needs to be paid to the consequential effects on productivity particularly in the human-dependant areas of the business system where knowledge and information are core.

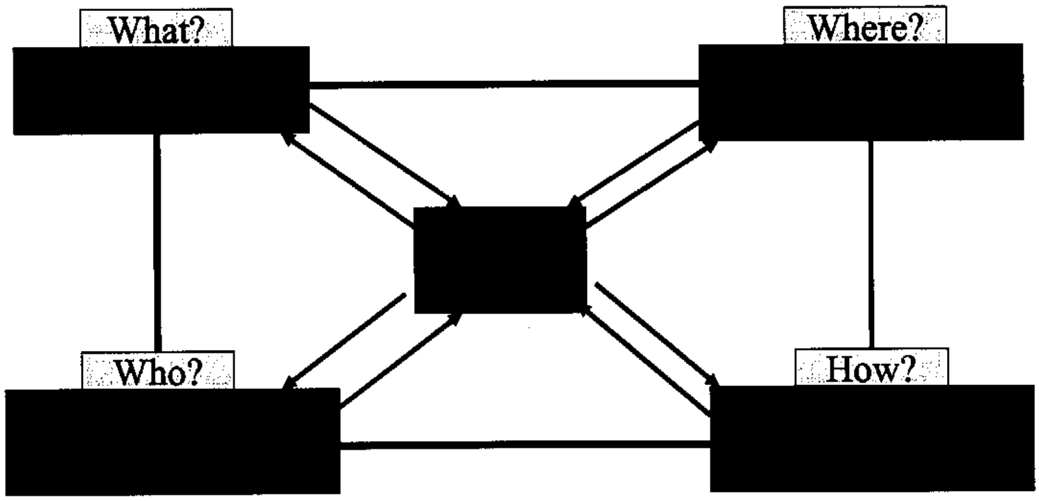
Aside from the environmental factors, the social and political factors, such as Marchand's acknowledgement of behaviors and values, are equally if not more important (2000(1):71). For an organisation to learn, information must be shared. For humans to share there needs to be a reliable level of trust and integrity in the information-sharing process (Tobin, 1997:36). There needs to be trust in the implementation process too as humans adopt and adapt to new tools, processes, technologies and directions which innovation in the new economy demands. Pivotal to the necessities of trust for sharing is an atmosphere endorsing and encouraging such behaviour and values, and an atmosphere created, maintained and nurtured by the leadership of the organisation.

### 2.6 Information Orientation

As Davenport so accurately describes, IT is the plumbing – it provides the infrastructure to facilitate the flow of information (2000:5). What is more important than the facilitation of flow is the quality of the information flowing through that infrastructure. The quality of information can only be assured through a holistic understanding of the information landscape. One seminal example of such an understanding is Marchand's concept of 'Information Orientation' (IO) (2001:255).

An organisation is considered to be orientated around information – the fundamental resource for knowledge creation – when it is aware that information flows through a organisation in a number of ways, both technological and human, placed in three broad categories of practice – IT, Information Management (IM) and Information Behaviors and Values (Marchand, 2000(2):13). Where IT is the enabler of the organisation's information system, IM refers to the people, procedures and policies that define and structure the interrelationships between where the information comes from; how and what it gets processed by; and where and who it goes to. Information behaviour and values refer to how the organisation's people and leadership extract and/or add value to the total information system (as discussed in section 2.5). Information therefore, needs to be managed far beyond the capabilities of a structured, inanimate piece of technology, theory or book of processes and procedures. Information is processed by human beings and the various factors of human behaviour need to be considered too.

For productivity and innovation to result from a process, the right information to the right person at the right time needs to be made available. The right tools need to be available to process and facilitate that flow of information. But the landscape faced by organisations competing in the knowledge economy is not just one of having the right tools. Organisations of the knowledge economy are faced with managing information as a strategic resource. The required 'information management strategy' demands acknowledgement of all the possible factors involved with managing the organisation's information. A possible strategy is Earl's Information Management Framework illustrated in figure 2.1 below:




Source: Fouche, 2003, adapted from Earl, 2000

**Figure 2.1: Earl's Information Management Framework**

Earl's framework defines various aspects to consider including the What (Information Systems); the Who (Information Management); the Why (Organisational Strategy); the Where (Information Resources); and the How (IT). Such an approach identifies information resources (IR), information systems (IS), information policies and management (IM) and IT as interdependent elements of the information processing and knowledge creating capability of and organisation and its people (Earl, 2000: 21). By taking into account all these factors, the organisation could be considered to be orientated toward information, enabling its potential to take advantage of the returns that the generation and application of knowledge provide.

## 2.7 Strategic Implications

The ability of the human mind to process the unlimited resource of information into knowledge and the ability to produce unlimited amounts of new knowledge through the continuous application to existing knowledge bases is the realisation of the power of information and knowledge as limitless resources uniquely offering increasing returns (Teece, 1998:57). The new economy is the manifestation of this realisation with the related recognition that information, knowledge and their application have the essential ability to drive innovation. They should therefore be considered as strategic resources for an organisation to harness, exploit and develop to achieve its business objectives (Probst et al, 1998:240). Business in the new economy needs to be considered in this strategic context.

# CHAPTER 3: BUSINESS IN THE NEW ECONOMY

## 3.1 Introduction

The implications of the new economy for business will be introduced in this chapter. The dynamic nature of the new economy will be discussed as the context to the impact of the information and knowledge on the business' value chain. The changes demanded by an information and knowledge orientated strategy on the business environment and a business' internal objectives and strategy will also be addressed.

At the core of all business strategy is the definition of a 'business':
*"...[an organisation that concentrates] on producing and selling products and services."*
(Drucker, 1994:48).

From a traditional perspective, a 'business' involves the processing of a certain set of inputs into a certain set of outputs. These inputs are also known as 'factors of production'. Historically, the three main headings of these factors are land (place), labour (people) and capital (Lipsey, 1990:4). Other factors that have been more recently been considered as factors of production include entrepreneurship (Bannock *et al,* 1992:135,158) and indirectly related to entrepreneurship – knowledge (Drucker, Ibid: 6). What is interesting to note about the two further 'factors' is the relationship between the concepts, both of which are fundamental to the growth and innovation of any business i.e. an entrepreneur uses knowledge in the identification, creation and execution of a new business, process, product and/or concept.

## 3.2 The Business and Strategy

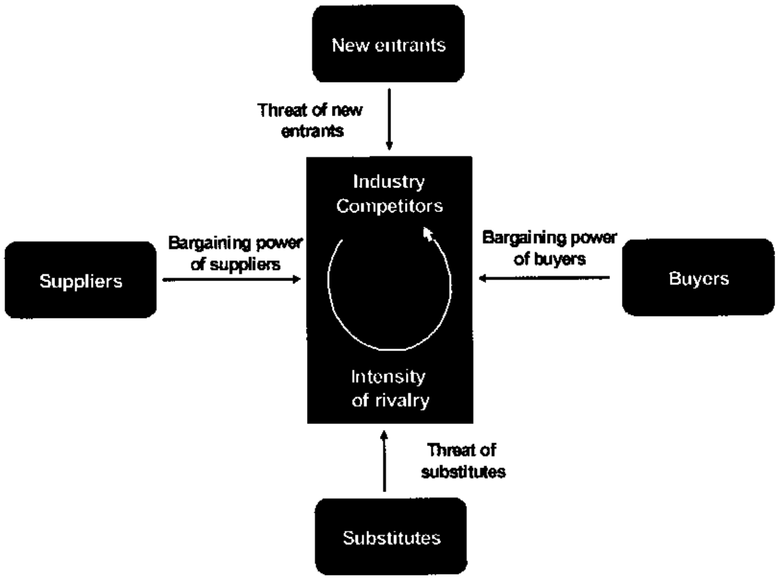
Business strategy has been devised and executed with the intention that it will be able to structure and guide the management of the relationship between the organisation and its environment in terms of the processes of production and consumption (Leibold et al, 2002:68). This need is no more relevant than in the dynamism of the new economy. Thompson and Strickland (1998) identify the factors that shape strategy as follows:

- Societal, political, regulatory and citizenship considerations
- Market opportunities, competitive conditions and industry attractiveness
- Resource strengths, competencies and competitive abilities
- Personal ambitions, business philosophies and ethical beliefs
- Shared values and organisational culture

The well-known, traditional approaches to defining and guiding business strategy that focus on the specific shaping factors above – for example Porterian and resource-based strategies – appear to inadequately take into consideration the concept, flows and effect of information and knowledge. This could largely due to the era in which they were devised and are therefore possibly due for revision to meet the demands of the new economy. Despite these limitations, Porterian models have however become widely accepted foundations of business strategy to date in business practice and theory as departure points (Rowe et al, 1990:151,159). Where the Competitive Forces model has an essentially external focus, the analysis of the organisation's Value Chain has an internal focus. Both models denote complex systems of relationships and, although unspecified at the time of their original publication and application, indirectly imply the generation and application of information and knowledge to evaluate the collective environments of a business.

### 3.3.1 The Competitive Forces Model

Michael Porter's Competitive Forces model, illustrated in figure 3.1 below, details how an organisation could analyse its position in relation to its external environment and categorises the forces that could affect that position.




Source: Applegate et al, 1999:64

**Figure 3.1: Porter's Five Competitive Forces**

Porter identifies five forces of the operating environment:

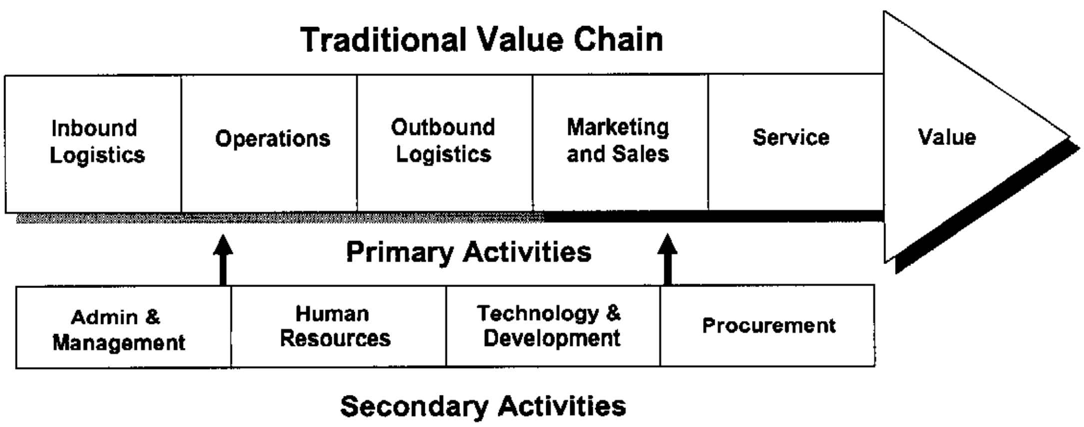
1. Threat of New Entrants
2. Bargaining Power of Suppliers
3. Bargaining Power of Buyers
4. Threat of Substitute Products and Services
5. Rivalry among Existing Competitors

Porter recognised these 'forces' as the prevailing influences that can affect the competitive positioning of an organisation in relation to the industry in which it places itself. By understanding the effects of the constituent elements of each of the 'forces' within an industry, an organisation would be able to identify their position relative to the other competitors for them to identify, protect and/or nurture their competitive advantage (Fleischer & Bensoussan, 2003:60–73).

The focus of the model is very much orientated around the industry and factors within that operating environment. In effect the 'forces' are a delineation of the factors that could affect the profitability and growth of a organisation within a chosen industry sector by recognising the specific conditions, actions and probable effects of participants in an industry's structure. These factors are the substance behind multi-faceted industry rivalry that forces a organisation to assess not only the external but also its internal ability to meet and gain advantage over the 'forces' to identify, consolidate and take the necessary internal actions to compete effectively. There is however, little focus given to how internal environmental factors contribute which is addressed by the Value Chain model (Fleischer & Bensoussan, 2003:105).

### 3.3.2 The Traditional Value Chain

A value chain analysis can be used to assess the organisation's specific internal capabilities – its strengths and weaknesses – for competitive advantage through the efficient and effective application of resources at its disposal. The value chain, as detailed in figure 3.2 below, is the interconnected organisational areas and activities involved in creating or bringing products and services to market (Applegate, 1999:71).




Source: Adapted from Earl, 2000:19

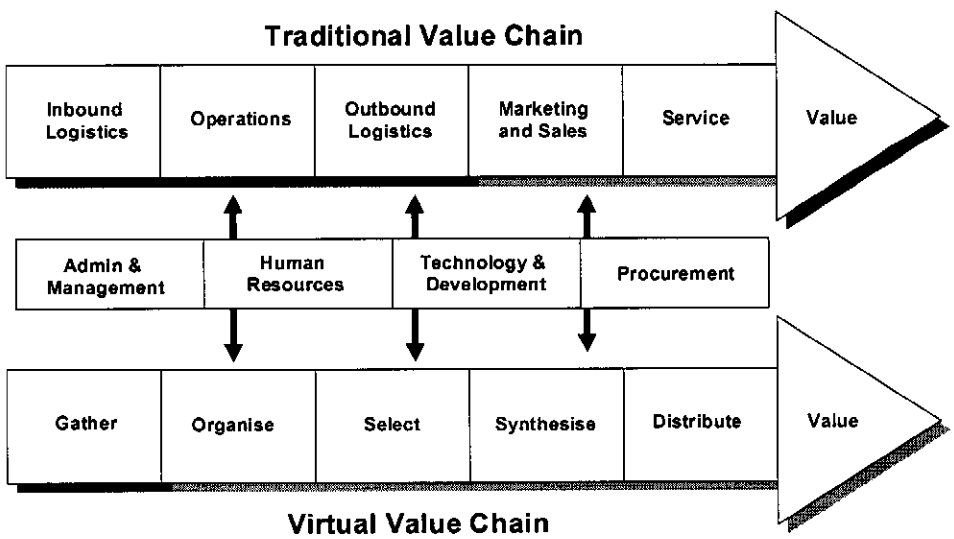
**Figure 1.2: The Value Chain**

The value chain describes the primary and supporting activities within a business – receiving inputs, and processing those inputs in the creation of outputs for a market of buyers of that output. They are the activities that add value to the eventual output once it reaches its buyers or 'customers'. The 'value' of the output for the customer of that product or service is the amount she is prepared to pay for that output commonly referred to as the 'price'. The 'value' of the output for the business is ultimately measured by the revenue generated by that price paid by the customer.

### 3.3.3 The Virtual Value Chain

Earl takes Porter's model one step further by identifying the productive force of information and the pervasive effect it can have on the primary activities of a business. He illustrates his argument by presenting the 'virtual value chain' devised by Rayport & Sviokla (Earl, 2000:18), illustrated below. The premise of this theory is that information is generated and can be captured during every stage of the traditional value chain – in every activity area. This information can be organised, selected, synthesised into different processes, outputs and inputs and distributed to any or all of the primary activity areas. The application of this information can radically alter existing concepts of the output, the process and the inputs required in the business. This information may also adversely affect the support activities of the business as their roles change in relation to the primary activities' support needs.

**Figure 2: The Virtual Value Chain**




Source: Adapted from Earl, 2000:19

In terms of 'value', an output with consistent application of information generated may change the nature of that output completely – the way it is conceived, created, distributed, marketed, sold and serviced. Customers may pay and/or buy more or less for that output depending on their experience, perception, need and/or desire of the output. The 'value' to the business is that the amount of information generated by an input, process or output, and the changes that that information can cause can severely effect the revenue streams realised from a particular output. Information becomes the catalyst for change in any aspect of the traditional value chain due to its pervasiveness and potential to provide feedback on existing processes, procedures, people and products. In the new economy where the business needs to be able to adapt to the inevitable demands of information from a dynamic, volatile external environment, information becomes the messenger of change.

The recognition and acknowledgement that information is the one common product in any business in any industry, redefines the strategy of business. The traditional approach to business where information supports the value chain – where the processes are information based – converges upon an 'informational' approach – where the product is information based. (Earl, 2000:18). At this point of business convergence, information becomes the product of the business in various formats:

- that reach the customer as a product in itself in the form of 'content';
- is distributed to, and utilized by, people involved with the primary and support activities to improve their processes and outputs through learning;
- is used in application by the business to make decisions and sense of the changes of the external environment. (Choo, 1998:1, 2)

By considering these points and the virtual value chain, a business should organise itself around information in partnership with appropriate strategies surrounding

Information Resources (IR), Information Technology (IT), Information Systems (IS) and Information Management (IM) as per Marchand's concept of Information Orientation discussed in section 2.6. Information, in effect, becomes the integrator of the various internal and external 'channels' – inputs, outputs, processes and markets.

### 3.4 Managing Information for Knowledge

The organisation's ability to collect, manage, store and distribute information and knowledge is a key requirement for knowledge creation to be maximized in the course of business activities. The application of an appropriate strategy in the new economy therefore needs to take into account the total business environment and the factors of the environment where business takes place. Aspects that received a great deal of attention in knowledge orientated business strategy surrounds the organisation and its ability to identify, generate and apply knowledge from its information and knowledge resources – to know and to learn – and in turn the methods and rationale for managing its knowledge.

Tuomi (2002) traces the origin and rise of information and knowledge orientated business practices from the new-found technological ability to process organisational information from the 1950's onwards. Early initiatives were focused around building information technology tools that would manage organisational knowledge (ibid: 2). There was a belief that all knowledge could be codified, classified, stored and accessed on need with an ultimate goal of creating artificial intelligence. The dynamics behind the social and cultural nature of knowledge was ignored in this paradigm. The communicative, personal essence of knowledge and learning came to prominence through the understanding and requirements of business intelligence in practice (ibid: 5) and the acknowledgement that information from the external and internal environment cannot be entirely technology driven and concurrently that knowledge and expertise for analysis and intuitive action cannot be programmed in totality. A further realisation (through the contributions by authors such as Nonaka and Choo) was that learning and knowledge creation are dependent on the sharing of information within an organisation between human knowledge workers in person and practice where the product and process of these interactions are enabled by technology, and not governed by it.

With the growing body of theory surrounding knowledge and its strategic value as an organisational resource, there has been a consequent development in theories relating to the appropriate knowledge strategy for an organisation to follow to achieve its business objectives. The departure point will be to assess the landscape the organisation faces and to identify and analyse the information and knowledge flows of that landscape to provide the keys to a substantiated and viable strategy.

### 3.5 The Information and Knowledge Landscape

The recognition of information and knowledge as strategic resources reveals a new perspective to consider the way an organisation goes about its business and its strategic goal of creating a sustainable competitive advantage in its business environment. From this perspective it is necessary to determine an organisation's knowledge 'landscape'. The identification and discussion of the various components of that landscape offer new insights to traditional theories of an organisation's activities and the strategies that direct it and ultimately provide the basis for a knowledge based strategy.

A business operates in an environment that consists of a multiplicity of external and internal factors (Lowe, 1999:2). Each of these factors represent flows of information and bodies of knowledge some in tacit form in customers, competitors, staff and their skills, experts and their expertise; others in explicit form in records, processes, products and technology. Each factor exists in its own right but in the context of business, these factors interact with each other in a system of interconnected relationships. These interactions allow the opportunity for knowledge sharing, learning, creation, integration and application. The combination of all these constitutes the organisation's knowledge landscape. The flows and usage of knowledge within the business landscape requires a recognisable structure for strategic choice, positioning and management of knowledge within the organisation.

### 3.6 The Link of Knowledge to Strategy

Business in the new economy brings with it unforeseen threats and opportunities from the external and internal environments and forces the organisation to consider its strengths and weaknesses in totality. The economy of today is fuelled by intangible products and assets, and business extending across nations and industry boundaries. Markets are more competitive than ever before with similar products of the same quality being extensively marketed and advertised to more informed, discerning and demanding customers. A new approach in business strategy is required to find competitive positioning and advantage in this new economy – creative and proactive thought and action focused on innovation, founded in the use and application of information and knowledge (Leibold et al, 2002:77).

Relationships with what were considered to be competitive forces of the past need to be considered in light of the value that they can add to the value chain, to the internal capabilities of the process of production, exchange and consumption. Customers are no longer consumers of products and services, they become a part of the intricate network of information and knowledge flows that an organisation must build and develop with its business partners on the recognition of the inestimable value that their collective knowledge can offer the organisation. Partnerships in this environment go beyond the structural obligations to shareholders, beyond internal resources and suppliers to include all stakeholders that represent the entire business landscape. A non-exhaustive list of stakeholders include: government; society; the environment; employees and their families; suppliers; customers; and even alliances and collaboration with existing competitors, potential substitutes and new entrants.

In the context of the organisation and its value chain, these partnerships create what Badaracco (1996) describes as 'knowledge links' between the partner and the organisation with competitive advantage coming out of how effectively the knowledge gained from these links can be applied. He identified the characteristics of successful partnerships that set appropriate objectives for a knowledge oriented business strategy of the new economy:

- Learning and creating knowledge as the central objective
- Intimacy between partners for co-operation and knowledge sharing
- Selection and scope of knowledge links to encourage diversity in innovation
- Extension of existing capabilities and transformation to new capabilities

## 3.7 Strategy in the New Economy

The realisation of the power of information and knowledge calls for a different perspective on an organisation's business environment and the strategy it should adopt to allocate its resources to achieve its objectives (Robson, 1997:5). In the new economy the determining feature of the environment is the prominence the of interconnected system of relationships that link the flows and usage of information and knowledge within and through an organisation and its business. The new perspective of this information and knowledge system demands a revision of the understanding of a system itself, from a sequential series of linear activities to an awareness of the complexity of the circular, simultaneous interactions between, among and through the various factors of the system (Kinghorn, 2002:317).

In this systemic paradigm, the concept of the system moves from a mechanistic structure to an adaptive, organic structure recognising the fluid interaction of animate (people, expertise) and inanimate (technology, products, processes) 'knowledges'. A strategy to extract maximum value from such a system should identify its constituent factors, but should avoid a predictive approach as to its outcomes because the dynamism of the flows within the system needs to be considered within a mindset of openness and expectancy rather than a mindset expecting specific courses of action.

In the new economy, competitiveness is ultimately determined by the organisation's ability to adapt its business to the complexities of an ever changing environment. The primary feature of an effective strategy therefore demands a shift in perspective before any shift in activity is required. Ultimately this mindset needs to originate within the leadership of the organisation in order for it to be disseminated and inculcated into the business and its functional levels (Botha & Fouche, 2002:284). Once again this challenge is human and cultural in nature rather than technical, but it must be recognised that knowledge is mobilised in the new era by technology. Hence, the appropriate strategy is best described as socio-technical in nature where technology, processes and people interact with the purpose to protect and extract maximum value from the various knowledge links the organisation has created and nurtured for innovation and transformation (Pan, 1998:57).

One particular strategic paradigm that, in reference to the argument above, and in application, potentially offers value to business in the new economy is Frederick Reichheld's theory on the economics of 'loyalty'.

# CHAPTER 4: LOYALTY ECONOMICS

## 4.1 Introduction

In the context and challenges of business in the new economy, the requirement for loyalty from customers, employees, investors and partners will be presented in the context of Reichheld's theories and models of 'loyalty' economics. With the move towards a customer orientated view to achieving sustainable competitive advantage, this chapter will be delineated to focus on customer loyalty. In so doing the advantages of customer centricity, particularly the management of the relationship between the business and the customer will be discussed. Further detail will in turn be given to customer information; customer relationship management; the importance of identifying customer motivators; and the structuring of such initiatives through customer loyalty programmes.

'Loyalty' is a timeless concept but for the purpose of this paper can be most simply defined as a commitment *"...to build lasting relationships..."* between different entities (Reichheld, 2001: xi). The term's application into the domain of business strategy however, demands a greater degree of attention as to the nature of relationships between the participating entities themselves, specifically the motives of what makes the relationships exist and last.

To establish the motives for the initiation and the continuity of relationships in themselves it is important that the discussion remained focused in the context of 'economics' rather than delve too deeply into the psychological or philosophical aspects of relation and motivation. An applicable definition of economics applicable to this context is:

*"...the [social] science which studies human behaviour as a relationship between ends and scarce means which have alternative uses..."* (Bannock *et al*, 1992:130)

### 4.2 The Economics of Relationships

To accurately assess the causes of that economic behaviour demands a brief investigation into the motives for relating towards such ends and the varied means to do so.

#### 4.2.1 Human Motivation

Wade & Tavris (1990:344) defines human motivation as:

> *"...an assumed process within a person that causes that [them] to move toward a goal...to satisfy a biological need...or fulfill a social ambition..."*

Alfred Maslow categorised sets of human motivators, their needs, wants and ambitions into what is become well known as the 'Hierarchy of Needs' (Wade & Tavris, 1990: 377) as follows:

- Self Actualisation & Self Transcendence e.g. personal growth, fulfilment
- Esteem Needs e.g. achievement, status, recognition, responsibility, reputation
- Belongingness & Love Needs e.g. identity, family, affection, relationships
- Safety Needs e.g. stability, security, protection, law
- Biological & Physiological Needs e.g. food, shelter, sleep, sex

These motivators can be split into two definitive categories – rational and emotional. Rational motivators include those that relate primarily to survival; they can be reduced to a rational cost-benefit calculation and on the analysis a decision can be made relative to the individual's focus of interest, objective or agenda. The agenda may be personal or may extend beyond the personal domain, in reference to an individual or group beneficiary. An example of this includes an employee or member of a community making a decision about the collective interest of the organisation. Rational motivators in the hierarchy include those related to survival – biological, physiological – as well as safety needs, although there will always be emotions involved in the decisions regarding 'rational' motivators.

With emotional motivators there is an inherent difficulty in accurately calculating the extent of their influence and effect over human decision making. These behaviour drivers (which include needs related to love and belonging, esteem, and self-actualisation) are endemic to the human condition but vary between individuals. Different individuals are motivated by different things in these domains and understanding the basis of emotional motivation requires a thorough knowledge of the individual themselves. This difficulty can be overcome by recording and analysing behaviour to identify similarities and defining categories. Examples of such categorisation of individuals into groups of personality types include Myers-Briggs Type Indicators, used in Management Profiling (Fleischer & Bensoussan, 2003:225–251). Researchers have gone one step further by segmenting individuals, usually on the demand of their corporate clients wanting to understand their customers, into identifiable categories (detailed in section 4.4.2).

There is some controversy and debate as to whether the categories Maslow propounded are hierarchical in that the one level of needs has to be satisfied before the next level can be considered as motives. For example, that hunger needs to be satisfied in order for any level of self actualisation to be realised. This one example is vilified in the instance of self induced fasting for religious reasons and hence there are a number of examples where motivators can be organised as horizontal as well as vertical. It is therefore fair to assume that needs may be complex relative to embedded and circumstantial conditions and prioritisation. The manifestation of needs may be hierarchical in structure but not in practice.

Regardless of Maslow's lack of scientific foundation for his theory, the categorisation does provide a level of structure in making sense of what does motivate human behaviour or, in other words, what the various 'ends' that may be sought are. In essence, the motivation for human behaviour is the fulfilment of needs on various levels – physical, mental, emotional, psychological and social. The interplay between these levels creates varied contexts which call to be considered in a full evaluation of human motivation. In the majority of circumstances these needs are defined and governed in source and extent by the individual. However, there are those interests that go beyond pure self, such as conditions of self sacrifice for a greater good (family, love, religious beliefs) which may be complex and collective in application.

### 4.2.2 Economic Motivation

In the context of economics, motivation towards the 'ends' of satisfying wants and needs are foundational to understanding the systems of human exchange in the processes of production, distribution and consumption. Each of these systems demand an exchange of the varied means of the different entities be they capital, land, labour; investors, employees, customers. For that exchange of means towards ends to be initiated and remain intact over time, each entity needs to be aware of the value of the exchange. A relationship between entities comes into existence when the value or mutual benefit between each entity for them to be motivated to participate becomes identifiable and quantifiable. Any shift in the balance of benefit or value proposition between entities, whether real or perceived, can change the conditions of the motivation and relationship of exchange. Real world examples of 'balances' include prices between producers and consumers; wages between employers and employees; and valuations between investors and businesses.

In the processes of economy, motivators need to be considered from both the individual and collective perspective. In recognition of these, production, consumption and distribution represent systems of exchange of varied amounts of complexity. Businesses by their nature are organisations made of a collective of individuals, objectives, processes, cultures and pasts. In this microeconomic domain, investors and owners interact with employees, suppliers, partners and customers in the processes of production, distribution and consumption. Industries are collectives of businesses that may have similarities with their competitors in the same sector but in relation to other industries experience vastly different demands and challenges. National economies need to be aware of the conditions of global, networked markets and how industries in other countries affect not only local industries and economic performance but all the factors regarding competitiveness of the nations themselves in terms of imports, exports and foreign exchange considerations. From the macroeconomic level, the businesses within all industries and the countries they operate in, need to be aware of even further relationships such as local and global legal and ethical regulations; business practice and protocol in home and foreign countries; and competing for the spend of consumers, customers and clients which may be common markets to other businesses, industries and economies.

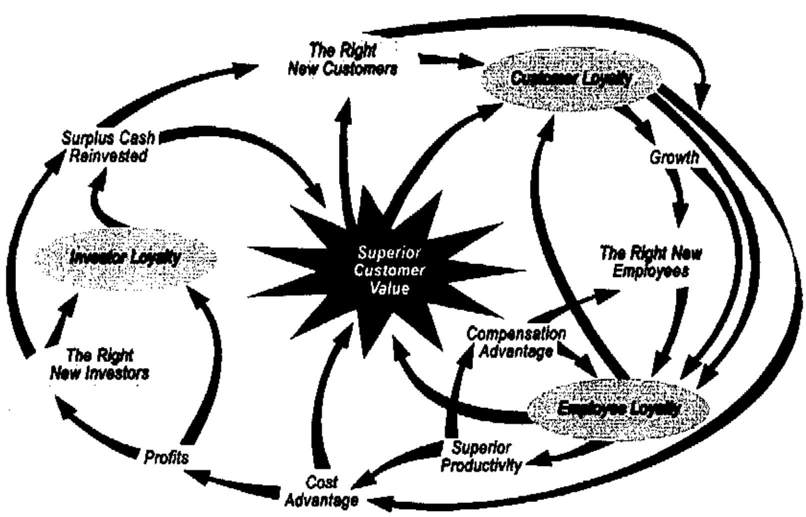
Where the human individual's fundamental motivators are survival and success, so too is survival and success the fundamental concerns of the collective business. For the human being to survive and succeed, it needs to satisfy its needs as detailed in Maslow's hierarchy. Despite the complexity in the systems of economic relationships, there is also a definitive set of needs towards which businesses, industries and nations are motivated such as productivity, revenue growth, profitability, cost efficiency, competitiveness and innovation. These primary motivators all drive toward the ultimate goal of achieving sustainable competitive advantage, where a business, industry or economy manages to maintain an advantage over its respective competitors over an extended period of time. Neither individual nor organisational goals can be accomplished without the continuity in the economics of relationships.

### 4.3 Loyalty Economics

Loyalty 'Economics' is a relatively new approach to understanding human behaviour and the relationship between ends and means. The theory was first posited by Frederick Reichheld in his book "The Loyalty Effect" (1996; 2001(1)).

#### 4.3.1 The Loyalty Effect

Reichheld offered new insight by deconstructing the business system in relation to the central role of the customer in the construction and flow of value. The value offered to and derived from the customer through the system of relationships between the three specific groups of stakeholders within a business system – customers, employees and investors (Reichheld, 2001(1):33). In Reichheld's paradigm of loyalty, customer value is calculated as the amount of value that can be derived from a customer's relationship with the business and its extended value chain (delineated as employees and investors) and vice versa. The Loyalty Effect, illustrated in figure 4.1 below, is the dynamic force that generates additional value and growth through a system of relationships between the three stakeholder groups.




Source: Reichheld, 2001(1):20

**Figure 4.1: The Loyalty-based Cycle of Growth**

In Reichheld's (2001(1):22) later work "Loyalty Rules", he placed further emphasis on a fourth stakeholder group being 'partners'. 'Partners' include those relationships with external entities such as vendors, suppliers or complementary businesses which add value to the business' proposition to the customer. In the context of the new economy, phenomena such as outsourcing, in-sourcing, contracting and strategic alliances have become increasingly prevalent, making supplier and distribution channel relationships critical areas of a business' value chain. In terms of creating and regenerating customer value, the concept of 'partner' loyalty is a necessary addition to Reichheld's set of stakeholders.

The dynamism of the cycle of growth depicted in figure 3 above arises from the interaction of the stakeholders in the business system. These interactions, beyond purely transactional incidents, indicate a system of relationships where investors, partners, employees and customers contribute value to the system itself. Each stakeholder has a series of contributions to make, but the determination of what contributions will drive the appropriate value in the system for all stakeholders concerned needs to be understood and defined. Different types of businesses will require different types of contribution from their stakeholders. By defining the *right* contributions, the *right* relationships can be defined and encouraged and thereby the *right* stakeholders sought and retained, in the sense that *right* indicates a measure of ideal value.

### 4.3.2 The *Right* Contributions

The definition of the *right* contribution will ultimately be dependant on the specific needs and objectives a business recognises as its own. These objectives may include industry, market or product specifics, but there are some fundamental reasons for the relationship's creation that could be assumed between stakeholders.

Partners in a business system, such as distribution channels and suppliers, contribute to the generation of revenue in a number of ways such as sales, availability, value added services, information and advice. Examples include:

1. Brokers that act as agents by selling a business' products and services and offering advice on the pricing and product as well as speaking highly of the business thereby becoming brand advocates.
2. Suppliers who endorse the quality of the end product and timeously provide goods and services necessary for the production of the end product at favourable rates.

Profitable partnerships solidify relationships within the system and as long as the conditions of the partnership remain understood and intact to the benefit of both parties, value can be derived from them into the future.

From an employee perspective, the time, effort and intellectual capital contributed by employees to support the pricing of the products value proposition is integral to the flow of value in the business system (Reichheld, 2001(1):91). Examples include customer care personnel who service customers providing feedback on the market's response and satisfaction with a product and administrative staff in other departments who support the brand's culture, purpose and promise by giving of their best at all times. For an employee to see the benefits of maximizing their productivity and remaining loyal to the business, the business needs to identify with the employees' needs and offer the appropriate incentives, recognition and remuneration in respect and accordance with those needs.

In terms of investors, their contribution can be defined in terms of their willingness see the value in a long term relationship with the business, focused on its potential to generate returns into the future. In so doing, the *right* investors create an atmosphere of stability and support, rather than one focused on deriving profit in the short term (Reichheld, 2001(1):154). For the investor to realise returns in the long term, a short term focus will need to be sacrificed in exchange for a view that supports the value that can be extracted from a business' customers over their lifetime. The business needs to support this investor proposition by making their focus on customer value central to their business objectives.

From a customer perspective, the business' contribution to the customer is a compelling value proposition which attracts, acquires and retains a customer's relationship (Reichheld, 2001(1):63). The customer's contribution to the system is the relationship with the business. This relationship includes the money paid for the business' products and services generating revenue, but it can also be extended beyond the method of exchange to include the provision of information to the business. With customer information, the business is in a position to inform its employees, investors and partners to ensure that the business' value proposition is continuously reinforced thereby protecting the collective relationships within the entire system.

### 4.3.3 The *Right* Relationships

As mentioned previously, monetary value (revenue) is derived from the price that a customer is prepared to pay for a product or service. The greater the price paid and the more items bought by the customer, the greater the revenue generated by the business. The greater the difference between the price paid by the customer and the cost of producing and servicing the good sold by the business' extended value chain (consisting of the business' employees and partners), the greater the profit generated from the exchange. The greater the profit realised, the greater the opportunity for the business to grow, deliver incentives to employees and returns to investors. It follows that one of the conditions of the *right* relationship in a business system is one of profitability. Another condition is productivity (Reichheld, 2001(1):117). If the business is unable to fulfill on the demands of its customers there will be lost opportunities for revenue generation, further value creation and ultimately sustainable growth. Both of these conditions are mutually dependent on the relationships between customers, employees, partners and investors within the business system. This is all fairly basic and logical economic theory. Where the new system departs from the *ceteris paribus* assumption above is its consideration of maintaining such a relationship over time.

If a profitable relationship between a business and its customers and partners can be realised not once, but repeatedly to the point of creating tenure towards a product, category or brand, the value generated through that relationship grows progressively, perhaps even exponentially. Where that profitable relationship is to the mutual benefit of the customer and the business, the continuity of that relationship will be to the ultimate benefit of the all the stakeholders in the system. Similarly, if a productive relationship between an employee or partner and the business is realised and maintained, the effect, in terms of the flow of value, can be multiplied to the ultimate benefit of all stakeholders.

The *right* stakeholders are those entities in the business system that are able to make the *right* contributions, and by nature of the superior value of their participation, create the *right* relationships between each other. For the purposes of delineation, the concept of the customer in the context of loyalty economics will be explored in detail.

### 4.3.4 The *Right* Customers

It can be seen then, that value generation, in Reichheld's view, is based on the stakeholders investment in relationships directed towards productivity and profitability. The central focus of the system is the extraction and generation of customer value. If the customer is prepared to pay the price for a product, value is derived by the business. The *right* customer therefore is a loyal customer where the business is able to extract that value for as long as possible. A critical requirement for this to become a reality is the identification of what is the *right* customer for any business. Different businesses have different types of customers demanding different strategies, but to survive, they all need customers. These strategies require an understanding of what a customer is; what makes a customer profitable to the business in question and how to identify, engage and retain the right customers (Reichheld, 2001 (1):76).

### 4.4 Customer Centricity

#### 4.4.1 The Customer

With reference to section 3.3.2, the buyer of a business' output is known as the 'customer'. From a traditional perspective, business was focused on the output of 'things' measured by volumes sold, product profitability and market share (Van der Merwe, 2001:431). With competitors moving into a market, 'things' or outputs could diminish in comparative value as similar products and services become available from alternative sources, diluting the market and existing revenue streams. In addition, the free flow of information in a market gives competitors the tools to affect existing product differentiation and competitive advantage. As the traditional differentiators of quality, price and availability disappear there is one factor of the value chain that holds significant potential and real value for the business, both commercial and informational – the customer.

'Know your customer' the saying goes. How is that possible considering the enigma of human psychology? There will never be one answer to that question but as discussed in Chapters 2 and 3, the usage of information allows a business to 'know' its environments. Processing and application of customer information therefore equips the business to know more about its customers.

#### 4.4.2 Customer Information

By identifying the various aspects of the customer, information can be defined and measured and specific methods, tools and processes can be applied to gather, process, store, analyse and distribute recommendations to decision makers within the business. Armed with appropriate and timely information processed to the point of potential intelligence, the business is in a position to apply that information to manage the business' relationship with the customer on functional, operational and strategic levels. Examples of this include the use of information to assist customer service representatives in identifying past customer experiences and the use of customer feedback in new product and service development.

Customer information can be collected against a number of predefined criteria and through the analysis of comparative aspects of the criteria, relationships between various customer and business characteristics can be determined. A non-exhaustive list of these criteria includes:

- Demographics:
  - Name, Age, Gender, Nationality, LSM, Marital Status, Language
  - Education Level, Household Size, Children & Ages, Religion
- Geographic:
  - Type of Home; Residential Address; Postal Address; Region; Nation
- Financial:
  - Income Level; Assets; Banking Accounts; Credit History; Investments
  - Occupation, Life stage, Business Ownership
- Transportation:
  - Vehicle(s); Modes of Transport Used; Frequency
- Communication:
  - Telephone – Home, Work, Fax, VOIP, Postpaid, Prepaid
  - Mobile phone – Network, Handset, Postpaid, Prepaid, 3G

  - Email Address(es) – Home, Work, Mobile
  - Internet Presence – Website; Access - Home, Work
  - Media Consumption – TV, Radio, Print, Online, Billboards
- Insurance:
  - Short Term: Medical, Vehicle, Home, Assets
  - Life, Accidental, Retirement
- Transactional:
  - Merchant, Merchant Category, Merchant Location
  - Products Purchased, Time, Date, Frequency
  - Value per item, Total Value of Purchase
- Psychographics
  - Interests, Hobbies, Activities, Personality Type

By managing the relationship of the customer through the processing and application of information, the business is able to take a proactive step towards to the creation and extraction of business and customer value. The logic of the management of customer relationships to realise their value over time was the precursor to the concept of Customer Relationship Management (CRM).

### 4.4.3 Customer Relationship Management

The concept of CRM evolved from related concepts of customer loyalty and customer intimacy in the 1990's (Cram, 2001:457). The present prevalence and popularity of CRM in its decade of development from a technology platform to a strategic paradigm is testament to prioritisation of the extraction of customer value in business. It is a field focused on the management of relationships with customers through the management and application of customer information to the business. The fundamental purpose of CRM is the realisation of the lifetime value of a customer (to be discussed in section 4.5).

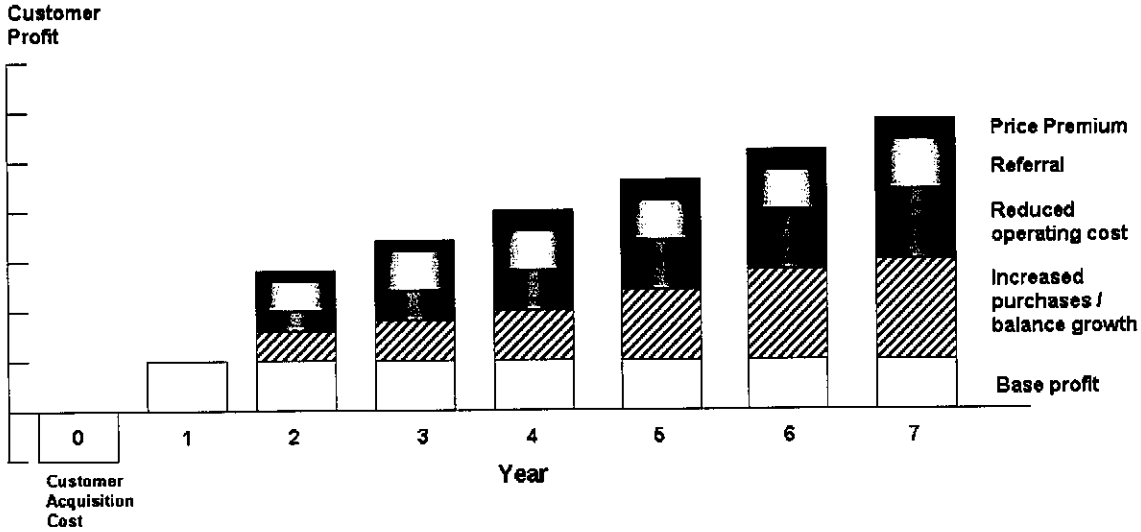
The management of customer information is the core of CRM as a specific task. Information and Communications Technology (ICT) is an essential component to the delivery of that core requirement. In its initial conceptualisation, CRM was not only considered as ICT driven through the integration of people, processes and technology but in many ways reduced to an IT system - an IT system that was only possible with the development of the multi-platform compatibility of 3rd generation programming languages and the capability of the relational database. CRM as a discipline has since progressed from its technological birth. CRM is now heading more toward a context which is essentially human in nature rather than technological by recognising the nature and value of the 'customer' and 'relationships' of CRM as an element of the business' strategic, operational and functional agendas CRM is no longer just a line item on the IT budget.

The appropriate use of CRM as a factor of strategy, operations and technology puts customer information in the hands of the business. What gets done with it thereafter is the determining factor of the success of the management of customer relationships and its fundamental objective to unlock lifetime customer value.

### 4.5 Lifetime Customer Value

The reality of customer value and the ability to extract that value over an extended period of time has led to the concept and calculation of the 'lifetime value of the customer' (LTV). If a customer purchases products or services over an entire lifetime, that customer provides significant LTV to the business as illustrated in figure 4.2 below. The longer the relationship with a customer, the more value realised, and the more information generated for the benefit of the business ultimately assisting in the continuity of the customer relationship.

Figure 4.2 below illustrates that the value a customer offers a business extends far beyond the initial purchase. An ongoing relationship allows the business to realise greater profitability through increased purchases, more cost efficient interaction, decreased price elasticity, and referral by those customers to other new customers. The power of referral creates a dynamic force where a business' customers become its sales force and hence significantly reduce the cost of acquisition.




Source: Reichheld, 2001(1):39

**Figure 4.2: The Lifetime Value of a Customer**

Conversely, the power of the customer can also be reflected in the customer initiating a relationship with a business and thereafter breaking that relationship due their needs and expectation not being met. By losing a customer, the business loses that customer's potential LTV (consisting of both monetary, referral and informational value) while also placing itself at the mercy of the customer's negative reactions rather than positive feedback and referral. Dissatisfied customers can potentially destroy a business' reputation:

*"Persistent defection means that former customers – people convinced the company offers inferior value – will eventually outnumber the company's loyal advocates and dominate the*

*collective voice of the market place. When that moment arrives, no amount of advertising, public relations or ingenious marketing will prop up pricing, new customer acquisitions, or the company's reputation."* (Reichheld, 2001(1):2)

The concept of LTV provides the business with the tools to calculate in financial terms the effect of customer economics in the business system. Other tools include the application of accounting methods such as Net Present Value (NPV), and applying this to the segmentation of a business' customer base. The appropriate calculation of the NPV per customer segment allows the business to determine comparative differences in the success and value of the segments they intend to acquire, nurture and retain (Hughes, 2003:75). Another tool which has come to recent acclaim is Peppers and Rodgers' Return on Customer (ROC) which aims to also measure LTV with a specific mathematical equation[1] in line with generally accepted accounting measures such as ROI (2005:61). By applying such tools to a customer base, the value of their relationships can be quantified. Such quantification allows for greater attention from the business and its financial reporting and indicators.

A further analytical method is known as Customer Value Analysis (CVA). CVA is an assimilation of a number of tools (including those mentioned above) to determine an organisation's competitive positioning in their market by focusing on the concept of value derived from the customers in specific segments (Fleischer & Bensoussan, 2003:180–204). Customer value is here defined as the value derived from a customer, and that competitive advantage is achieved through the maximisation of that customer value through focused market and customer segmentation strategies manifested as follows:

- Moving the customer from price dependant to value based decisions
- The capitalisation and focus on the organisation's delivery of value

[1] $ROC = \dfrac{\text{Cash flow from customers during period 'y' + change in customer equity during period 'y'}}{\text{Customer equity at the beginning of period 'y'}}$

- Low cost, highly effective viral marketing and customer advocacy
- Improved customer retention and realisation of their lifetime value

The outputs of such manifestations is simple – profitable, sustainable growth. By focusing on the concept of the customer as central to strategic objectives, the retention of that customer not only mitigates risk but also reduces transaction and life cycle costs as opposed to an acquisition focused model. In addition, the recognition of customer value and the direction of product and service development and delivery, tracked, sourced from and exceeding customer expectations elevates their perception and crystallises their experience of value increasing the propensity of the customer to manifest and deliver ongoing, growing value to the organisation.

With the application of CVA, information gathering is focused on the customer to determine optimal segment strategies, perceptions, expectations, satisfaction, price sensitivity and the propensity to churn. The feedback and analysis from these exercises define the conditions of the environment and allow the business to internalise what has been learnt in order to define and maximise its resource allocation (and associated competencies and capabilities). CVA assists the business to meet customer expectations, strategic agendas and competitive positioning according to the profitable segments of the market. With the realisation of the concept of LTV and the results of CVA, the rise of customer-based strategy as a business imperative is a clear consequence. But how does a business maintain a relationship with customer and satisfy customer's expectations for a lifetime and ensure their tenure?

### 4.6 Customer Loyalty

As an extension to the understanding of the traditional and virtual value chain, the realisation of the value of a business' output is crucially dependent on the buyer of that output's custom. From a business system perspective, Reichheld recognised that value is generated when a customer is prepared to engage with the business and purchase a certain output. In the consideration of purchasing an output, a customer relates that output to the satisfaction of a specific need or want they may have. By purchasing a certain output, the customer believes and expects that the need or want will be satisfied. Should a customer's expectations be satisfied, it is fair to assume that the customer's experience of that output was positive and it is likely that a positive relationship has been established. This does not mean however that the relationship will remain positive and that the customer will continue to purchase those and other outputs from that same business. Customer satisfaction merely increases the propensity of a customer to re-purchase outputs from that business. It is up to the business to nurture that relationship into long term value, a relationship of tenure and loyalty and realise the full benefit of the customer's LTV.

Needs and desires however do not clearly define the complexity behind a customers propensity to purchase a particular product or service. A non-exhaustive list includes quality, price, timing and availability, as well as more sensory, physiological and emotional factors such as placement, branding, packaging, status and persuasion (Underhill, 2000). There are a myriad of dynamics that can affect the psychology of a customer's purchasing patterns. Considering the complexities of why customers buy, how does a business try to understand the customer - their most important stakeholder? The answer is to build, maintain and develop a relationship with them.

Customers, whether they are groups or individuals are complex systems of rational and emotional desires and motivators. Human beings are the buyers and consumers of the output of any business. Products and services therefore, when consumed, are personal – personal in the sense that the customer, a human being, has a personal experience of that product or service from which he/she then can relate to. That experience creates a relationship not only with the product or service but with the provider of that product or service as well. Similarly, for a business to relate to a customer it needs to have an experience of that customer. Information provides the thread to link the business with the customer and create the potential for dialogue.

The effective management of customer information – communication, collection, processing and application – is the foundation of knowing the customer. It also provides the business with the intelligence it needs to adapt to its customer's needs and expectations to realise ongoing value from its customer's loyal relationship to its brand, product and service. Such a loyal relationship is characterised through referral, repeat purchase, mutually beneficial interaction and dialogue between the customer and the business. This is made possible by proactively managing the relationship between them, for the benefit of all stakeholders involved.

### 4.7 Systemising Loyalty

A committed, lasting, loyal relationship seems to be an elusive ideal in the new economy. Promiscuous customers tend to throw traditional models of segmentation, prediction and profiling into a system of dynamics that could prove very difficult to maintain track and forecast. Accurate forecasts however, are essential to the process of drawing up budgets, managing them and achieving targets and objectives in all aspects of a business and its operations. Reichheld's concepts of the *right* stakeholder relationships is founded on the effect that loyalty between stakeholders within a business system can create and sustain results on the bottom line supported through measures and tool such as CVA, LTV, and ROC. The recognition of the *right* relationships in terms of business objectives serve each other in a revolving system of value creation for all stakeholders.

Once the business recognises the customer as a key source of achieving business objectives, the prescription is to conceptualise a platform to draw the *right* customers (the source of revenue and profit) to the business, its brands and its various products and services and keep them there. This platform should aim to nurture customer loyalty, inducing dialogue between the customer and the business, structuring and measuring the flow of value and information in the business system. Some examples of such platforms offer certain incentives to persuade the customer to interact with a business in a new information-oriented, intimate way. Whether these inducements are considered as rewards, benefits or value added services, these platforms have become commonly known as *loyalty programmes*.

# CHAPTER 5: LOYALTY PROGRAMMES

## 5.1 Introduction

This chapter will present various analyses of loyalty programmes as business systems focused on supporting the relationship between a business, its stakeholders, and its customers in order to derive value from that customer over the long term. Local and international examples of loyalty programmes and their performance will be presented against the conceptual frameworks of loyalty and information and knowledge management discussed in the preceding chapters. The case studies selected are:

- Tesco Clubcard (UK)
- Discovery Vitality
- Dis-Chem Benefits

These case studies are the primary source of practical evidence to contribute to the theoretical argument of the paper. As the selected method of research, case studies have been used due to the nature of the question of the paper being addressed, the subjects of the argument and each of the programmes themselves, which correlate with applicable criteria for case studies used as investigative tools (Fidel, 1984:273):

- A large variety of factors and relationships are included in the study
- No basic laws exist prior to determine important factors and relationships
- When the factors and relationships can be directly observed

With the comprehensive analysis into each programme, the intention is to identify, if any, the purpose of why loyalty programmes exist and the nature and substance that makes the relationships between the business, its customers and other stakeholders, in the context of loyalty economics, possible.

## 5.2 Loyalty Programmes

A 'loyalty programme' can be defined as:

*"A membership structure that aims to foster customer loyalty usually defined in behavioural terms such as frequency and value of spend"* (Conradie, 2004(1):4)

Where the primary objectives of a business are profitability and productivity, core objectives and outcomes of a customer focused loyalty programme include:

- Retention - Keeping the *right* customers, year on year
- Development - Increase customer spend within and across products
- Brand affinity - Customer-driven emotional loyalty to the brand
- Life Long Value - The realisation long term value from a customer
- Relationship Management - Knowing the customer and delivering on needs

(Golding & Turgel, 2004)

There are multitude of different structures that programmes are delivered through, with various packages of benefits and incentives aimed at rewarding the *right* behaviours relative to the business' needs and objectives. Categories of reward mechanisms as well as their intended rational and emotional motivators include:

- Points - Earn and spend virtual 'currency' (Value accumulation)
- Discounts - Reduced rates on purchase (Spend more, pay less)
- Information - Provision of content (Appropriate help and advice)
- Privilege - Preferential access (Rarity, exclusivity, status, prestige)
- Services - Complementary tangible services[2] (Relevant to lifestyle needs)
- Hybrids - Combinations of part or all of the above

(Humby et al, 2003:30-32)

[2] e.g. Emergency assistance such roadside, home and medical services; Concierge services; Airport lounge access; Insurance

In certain circumstances, loyalty programmes have also become customer acquisition tools (Conradie, 2005:16). The increased value proposition provided by the additional features and benefits of a loyalty programme attached to the purchase of a product may incentivise customers to shift their spend from a competitor, giving the business with a loyalty programme a competitive advantage. In the current market where loyalty programmes are becoming common features of an industry or product offering, they are forced to provide superior value to both the customer and the business operating it in order to maintain their role, operation and respective competitive advantage in the market (Conradie, 2005:21). David Brosse, an executive from MyPoints, a loyalty business in Europe, believes that:

*"Competitive advantage can be gained by those companies which invest in, and interpret the data they have and then do something with it. This is essentially where a reward programme will stand or fall."* (Conradie, 2005:28)

**5.3 Case Study Overview**

There is a growing number of loyalty programmes in South Africa and around the world which could have been presented as case studies. Due to limitations for this paper, detailed analysis of three programmes were chosen to ensure that their discussion and analysis was justifiably comprehensive. Qualifying criteria used for the selection of the case studies presented included:

- Information orientated, technology-enabled structures
- Customer orientated corporate purpose and strategy
- Consistent programme and business performance

The three selected case studies are presented in the same format for the purposes of consistency and reference. Each case study opens with an overview of the business to which the programme of analysis in linked, to establish their respective market contexts. The overview includes details such as each business' origin and purpose, their performance and growth (as far as the details are available), as well as a brief introduction to each programme. Information related to each case study was compiled from books, independent reports, corporate communications, informal interviews with representatives where possible, as well as personal experience and analysis relative to each programme.

In the four further sections of each case study, each programme will be discussed in terms of their functional, operational, strategic and performance-related aspects. In the functional overview, each programme is discussed in terms of their customer's interaction with it. In this section, details such how the customer would interact with programme and the benefits offered are presented to review the programmes function in practice from a customer's perspective. In the operational overview, the inner workings of each programme from the business' perspective are addressed. Details regarding the system of relationships between the various stakeholders in a programme are highlighted, particularly the information flows between stakeholders as well as the information systems that govern the operation of the programme. In the strategic overview, the purpose of each programme is discussed in the context of each business' objectives and the role the programme plays in achieving them. Each case study is concluded with an analysis of each programme's performance against business orientated indicators and programme growth in terms of membership, subject to the availability of data on revenue, profitability, customer acquisition and retention figures.

## 5.4 Tesco Clubcard

### 5.4.1 Company Overview

Tesco is one of the largest retailers in the world, with over 2000 stores operating in 13 countries across Europe and Asia and employing over 360 000 people. It was founded in London, in the United Kingdom in 1919, as a single grocery store and, in just over 85 years, has become a multinational corporation that posted a £ 2 billion profit in 2005 (Tesco (1), 2005). The primary focus of the business is food retailing, but the products and services sold in their various stores include non-food items such as clothing, books, telecommunications, petrol and personal finance. Their products and services are available through their 'brick and mortar' store network as well as over the internet through their online operation, tesco.com. Tesco's stated corporate purpose is:

"*...to create value for customers to earn their lifetime loyalty...*" (Tesco (1), 2005)

This statement indicates an apparent shift from the assumed purpose of business in the modern economy towards the maximization of shareholder value but does it? In the context of the economy driven by the customer and their consistent loyal spend, any business looking to offer their shareholders – their investors – value would be to put the customer first. The corporate values are focused around the relationships they have with their customers as well as their staff which they consider as key to their ongoing success. These values are encapsulated in the three pronged 'Every Little Helps' strategy which delineates the importance placed on how their customers and employees relationships impact their business (Tesco(1), 2005):

- Shopping trip – including clear aisles, the right products at the right price, no queues and great staff. Keeping focused on these core aspects of their business keep Tesco focused on what is their customer's experience of the business' value proposition as a retailer.
- A great place to work - to treat their staff with respect, with service orientated management, providing them with opportunities for growth and keeping them passionate about the business. In line with Reichheld's principles, happy employees contribute to creating happy customers.
- The way we work – refers to how the business is focused on how to make

Tesco a better place for customers to shop in and the staff to work in applying simple processes to contribute to revenue maximisation and cost efficiency.

In alignment to its very clearly stated purpose, Tesco's introduced a customer loyalty programme called 'Clubcard' which had been tested in certain stores since 1993 but was officially launched in 1995. The business decided to introduce the programme as a response to market research exercises where customers started to ask questions about where and what Tesco's loyalty to them was, considering their ongoing loyalty to buying at Tesco (Humby et al, 2003:8). The fundamental premise of the programme was to support their customers spend and reward their customer's loyalty. It was Tesco's way of saying 'Thank You' (Ibid:47).

### 5.4.2 Functional Overview

From the customers' perspective, a Tesco Clubcard rewards them with money back vouchers relative to their spend through Tesco stores. Each time customers make a purchase through a Tesco pay-point, whether in-store or online, they are requested to supply their Clubcard or Clubcard number respectively. At its foundation, the customer is rewarded 1% of the money spent on goods and services bought through a Tesco outlet in the form of Clubcard 'points'. This percentage reward on spend may vary relative to certain products (more points may be rewarded for different product categories), payment method (Tesco Personal Finance cardholders get additional points) and promotions (more points may be offered on certain products at certain times). Points are accumulated per card number and on a quarterly basis the points are converted to monetary value vouchers to be redeemed in store. When the customer reaches a certain points threshold equivalent to a minimum voucher amount (£2.50) at the time of a quarterly mailing, the customer is sent this in-store voucher. Other discount vouchers for products and services they have already purchased are sent with the reward voucher as well as other vouchers introducing new products and incentivising the purchase of those product in categories 'un-shopped' by that customer to date. These vouchers are distributed by postal mail, accompanied by a Tesco magazine (Humby et al 2003:92).

Each customer who signs up for a Tesco Clubcard is required to supply details regarding their name, address, contact details, size and ages of their family and sign acceptance of their privacy policy, allowing them to send you information with your permission (Tesco (2), 2005; Humby et al 2003:46).

The programme, in principle, is by no means unique. Formalised retail loyalty programmes have been in existence for over a hundred years where customers of certain co-operative supermarkets were rewarded with dividends relative to their cumulative spend. Where the programme does depart from traditional models is how it tracks spend relative to the customer information collected and how the mining and analysis of the data leads to customer and business insight.

### 5.4.3 Operational Overview

When customers use their Clubcard, their spend is recorded against the products and services they bought and their personal profile. With the transactional information collected, Tesco is able to identify what products each customer purchases as well as those product categories they do not purchase from, also known as 'shopping basket' analysis. This process of identification and analysis demanded an integrated approach between the business, its employees and its partners to achieve its purpose.

In order to collect, process and analyse the data available to them, Tesco had to upgrade their systems (technology and processes), staff (people) and analytics capabilities to handle the information flows to and from what are now 12 million

Clubcard holders across their huge store network, interacting with their business on a daily basis. For this process to be a success, Tesco had to adopt an approach that integrated the use of Clubcard in each one of its customer/employee contact processes. Without the use of the Clubcard, Tesco is unable to identify which customer bought which product and hence, all staff are trained to request the customer's Clubcard as a fundamental feature of the initial customer contact at checkout. In their online environment, this is somewhat easier where the Clubcard profile can be stored and related with each log-in and purchase on their site (Tesco (2), 2005). Beyond point of entry, Tesco had to resource itself with the necessary IT systems to integrate the various flows of information from their stores and other customer contact points in order for analysis to be made off reliable data. This involved not only the purchase of data warehouse infrastructure and analytical software but also the partnering with specialists such as Dunnhumby, a UK-based marketing data specialist company (Humby et al, 2003:54).

The data collected and analysed allowed Tesco to split their customer database into segments reflecting who their customers are by looking at what they bought. Tesco uses this information to send relevant offers to certain customers based on their spend and demographic profiles. From a mailing perspective, by 1999, Tesco was mailing out between 8 – 9 million pieces of mail quarterly in total, in over 145 000 different variations, directly determined by the spending habits of their customers (Humby et al, 2003:117).

In addition to the structural and systems issues, Tesco had to be aware of a number of other associated challenges. With the quarterly mailing of vouchers, stores had to gear themselves for significant peaks in traffic and demands on the store infrastructure and staff. Timing is a crucial issue in delivering on their customer promise to make their shopping experience more than satisfactory. Security features around the vouchers as forms of legal tender needed to be considered. Tesco was in effect printing money with the introduction of mailed vouchers and hence the processes of distribution and creation needed to be secured to avoid fraudulent behaviour that could negatively impact the business (Ibid: 121). All the operational demands were met due to Tesco management's understanding of Clubcard's immense strategic value.

### 5.4.4 Strategic Overview

Matching customer and product criteria effectively turned what appears on the surface to be a customer rewards programme into a business wide intelligence system. With the integration of Tesco's point of sale system, with the customer information housed in the database of Clubcard members, Tesco for the first time was able to analyse which customers bought what products, at what times in which stores. In the words of Tesco's chairman, Sir Ian McLaurin, at the presentation of Clubcard's trial results before the national launch in late 2004:

*"What scares me about this is that you know more about my customers in three months, than I know in 30 years."* (Humby et al, 2003:57)

Powerful words indeed, but more importantly were the actual implications of the intelligence derived from the Clubcard programme as it launched the following year and has grown to over the last decade. For Tesco, the Clubcard programme shifted the process of decision making within the business from, by and large, intuitive to analytical (Ibid: 112). Tesco started to use the Clubcard data to guide strategic and product development within its core business as a food retailer and beyond.

Since the inception of the Clubcard programme, Tesco has launched a bank – Tesco Personal Finance (TPF) – changed its store formats ('Extra' stores), shopping hours and own-brand product lines ('Finest', 'Free-from and 'Fairtrade' ranges); launched a telecommunications division; an online bookstore; a virtual store (Tesco.com); and its own clothing ranges ('Florence+Fred' and 'Cherokee' ranges) in addition to global expansion into European and Asian markets (Tesco(1), 2005).

To what extent the Clubcard programme has a directly attributable influence over these decisions is arguable, but by all accounts Clubcard's contribution to the development and execution of Tesco's strategic moves is undeniably significant. One specific example was in the launch and growth of TPF. The Clubcard customer base not only offered Tesco a contained audience through the use of distribution and advertising channels such as the quarterly mailings and magazines, but the analysis and recommendation derived from Clubcard transactional data provided Tesco decision makers with the ability to:

*"...target the right [financial services] products to the right customers at the right time."*

(Humby et al, 2003:182)

The new found ability to know their customers through their spending habits allowed Tesco to develop the programme in line with the changing needs and wants of their customers. The primary programme was enhanced since its inception to include special interest and lifestage 'clubs' such their Baby Club, Kids and Toddlers Club and World of Wine Club to appeal to certain segments (Ibid:194). These entities focused on deepening the relationship with the customer and in so doing, drawing the customer closer to the Tesco brand and business through emotional (recognition) as well as rational (points per spend) benefits, giving Tesco the opportunity to extract not only additional spend and revenue but also information and feedback.

The Clubcard programme has also had to re-evaluate itself on a continuous basis as it very quickly found itself competing with their competitors' customer loyalty programmes looking to emulate the response Tesco received. As a loyalty currency, Clubcard points were competing for customer interest and spend in a market with other loyalty programmes that were offered by their competitors such as Sainsbury's, Safeway or Boots as well as entrenched multi-vendor programmes such as AirMiles and Nectar. Tesco has managed to keep momentum within its programme through either partnering with programmes such as Airmiles as well as looking to increase frequency and options of redemption for non-Tesco core product such as travel through Clubcard Deals (Ibid:215). Ongoing analysis of competitor activity in the comparative attractiveness of the programme itself is a key requirement for the continuation of customer participation and Clubcard's positive performance as a core component of their business strategy.

### 5.4.5 Programme Performance

Clubcard had an unequivocal effect on the performance of Tesco's business illustrated not only by the business indicators to follow but also statements made by Tesco's executive management. Tim Mason, the current group Marketing Director and one of Clubcard's strongest supporters from inception:

*"...without Clubcard, the Tesco brand would be a significantly different brand, today ...with the data, what we have to do becomes as plain as the nose on your face. It immediately changes the behaviour of the business."* (Ibid: 3)

Sir Terry Leahy, Tesco's current Chief Executive Officer (Ibid:2):

*"We could not have created the dot com business without the data from the loyalty card."*

These direct comments are testimony to the success of one of the world's largest loyalty programmes with over 13 million cardholders (Conradie, 2004:51). Since the inception of the Clubcard programme in 1995, Tesco not only became the largest retailer in the UK, but has managed to hold onto its position for over 8 years. (Humby et al, 2003:2, 74) Some further highlights of initiatives and results which Clubcard contributed towards Tesco's 2003 financials not yet mentioned include:

- Since its 1997 launch, TPF has grown to service 3.4 million customers
    - posting £96 million in profits

    - lent over £1 billion in loans
    - 500 000 customer insure their cars with TPF
    - 250 000 customers insure their pets with TPF
- Tesco.com is the largest grocery e-tailer in the world
    - Delivered goods to more than 1 million homes
    - 400 000 regular shoppers
- Non-food sector (including clothing, books, appliances, furniture etc)
    - Revenues in excess of £200 million

Humby et al (2003) note various Clubcard effects as interesting business indicators:

- Mailed over £1 billion in vouchers by 2002 and made a profit from them
- Generates more than £100 million in incremental sales every year
- In 1996 market research said customer spend had increased by 28% in Tesco
- Voucher redemption rates of 20%-40% compared to normal sales promotion redemption rates of 5%
- By 1996, Tesco could collect data from 66% of the 600 million baskets bought

Conradie (2004:57) corroborates these details with further related statistics:

- Tesco prints over 60 million copies of the Clubcard magazine
- Tesco posts over 50 million packs a year

In consideration of their business, Clubcard's data, the information it produces and the intelligence that ends up being applied to the organisation, is the glue that binds all the stakeholder of the Tesco system in its totality. From its suppliers and partners, to its employees in various operations, Tesco has used what it knows about its millions of customers to maintain its competitive advantage, generate additional revenue and become more cost efficient. Clubcard enables Tesco to be a learning organisation, and capitalise significantly on the knowledge they have generated.

## 5.5 Discovery Vitality

### 5.5.1 Company Overview

Discovery, founded in South Africa in 1993, is an integrated financial services company offering health and life insurance orientated products and services. It is a listed entity on the Johannesburg Stock Exchange and a subsidiary of the FirstRand Group. Discovery has grown from its humble beginnings to a gross income of over R3.5 billion and posting an operating profit of over R 700 million in 2004, just ten years after its creation (Discovery, 2005). It consists of five separate companies and selected details related to each are listed below:

- Discovery Health - founded in 1993:
  - Private medical insurer and administrator, based in South Africa
  - Manages over 1.6 million lives
- Discovery Vitality – founded in 1997:
  - A wellness programme providing special offers on lifestyle orientated goods and services according to a policyholder's health status.
  - 1 million members subscribe to this monthly fee based programme
- Discovery Life – founded in 2000:
  - Life assurance company with over 100 000 South African policyholders
- Destiny Health – founded in 2000:
  - Private medical insurer and administrator, based in the United States
  - 40 000 lives under management
- PruHealth – founded in 2004:
  - Offers private medical insurance and is based in the United Kingdom

- Joint venture with Prudential plc

Discovery's stated core purpose is:

*"Making people healthier and enhancing and protecting their lifestyles."*

(Discovery, 2005)

To achieve their purpose, Discovery considers their 'people' – employees, partners, customers, the definition is not clearly defined on their website – the principle ingredients of success (Discovery, 2005). In addition to their internal competencies, Discovery's loyalty programme, Vitality, is intimately structured in activating the intention of their core purpose. The programme was apparently conceptualised by their current CEO, Adrian Gore, one night lying in the bath. He describes its origin:

*"I had this idea of creating a 'health bank'...instead of saving money you would save your health. You would make 'health deposits', and you would get points that were redeemable for various rewards"* (Dugmore, 2005:9)

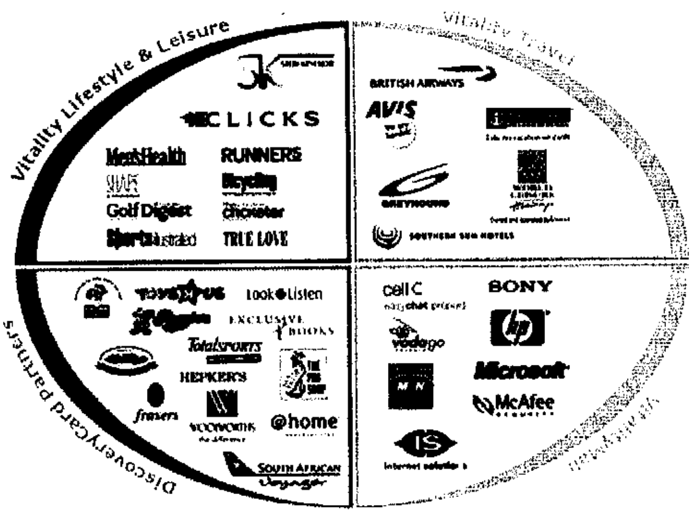
In 1997, what is now regarded as the best known wellness rewards programme and considered by many as the benchmark of a successful loyalty programme in South Africa, was launched (Conradie, 2003:70). The programme is a hybrid of points generating schemes, designed to incentivise frequency of behaviour in terms of usage or spend such as the frequent flyer programmes like South African Airways Voyager or the Tesco Clubcard respectively, synthesised with other benefits that are not behaviour related, but are relevant to the business' core insurance products provided on an exclusive basis to their customers (to be discussed in more detail in section 5.5.2). The premise of the Vitality programme is to incentivise their customers to become and stay healthy in essence to change their behaviour. To do this, Discovery's executives realised that such a change would need to be motivated through offering benefits to their customers appropriate and relevant to their lifestyles. Neville Koopowitz, Discovery's current Group Marketing Director and Managing Director of Vitality, acknowledges that:

*"It's hard to change behaviour…if you're going to make long term behaviour changes, you need big incentives. At the heart of Vitality is a king of benevolent bribe. "* (Dugmore, Ibid)

With over a million Vitality members of their 1.6 million lives covered by a Discovery insurance policy, it seems that the bribe works or does it?

### 5.5.2 Functional Overview

To qualify to participate in the Vitality programme, an individual or family needs to be a policyholder of either their health or insurance product ranges. To become a member of Vitality policyholders are then required to pay between R62 – R82 per month depending on the number of dependents linked to the principle member.



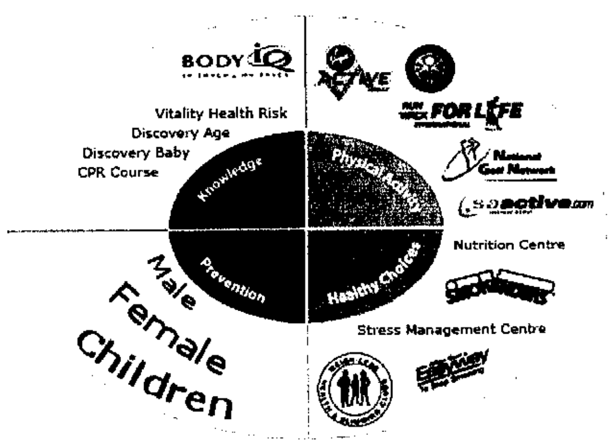

Source: Discovery, 2005

**Figure 5.1: Vitality Benefits Partners**

These fees then give members access to a host of discounted, and in most cases subsidised benefits that are exclusive to Vitality members covering a broad spectrum of a policyholder's lifestyle spend e.g. discounted movie tickets, magazines, gym memberships, airline flights, car hire, accommodation, electronics, telecommunications (Discovery, 2005). These benefits have gone through various changes in partners, price and participation over the years with the latest exclusive offer being the Discovery Visa Card, a credit card with integrated discounts at certain retail and travel partners.

These offers are accessible through partner outlets, online, through the Vitality Mall on the Discovery website and the Vitality customer call centre. Due to the fact that members pay to be a member of the programme, there is some debate as to whether Vitality is in fact a 'loyalty' programme and not just another product, offering lifestyle benefits instead of insurance cover, sold by Discovery (Conradie, 2004(1):4). The debate is somewhat negated when the concept of Vitality's points structure is applied to the entry level standard package of benefits.

The Vitality programme is tiered into four 'statuses' – blue, bronze, silver and gold. Each tier has additional benefits accessible only to those members achieving them. To progress from one tier to another where blue is the entry level and gold the pinnacle, members are required to perform certain activities for which they are awarded points (Conradie, 2003:70). These points do not have any direct monetary value but they do translate into value in terms of higher discounts across the Vitality partners according to your tier status. The activities that are awarded points can be split into definable segments for ease of understanding as illustrated in figure 5.2 below.




Source: Discovery, 2005

**Figure 5.2: Vitality's Behavioural Segments**

Within each segment, the member has the ability to earn points by completing certain actions, such as updating personal details and health profiles on their individual profiles on the Discovery website; completing certain health orientated programmes or courses such as their stress, nutrition, stop smoking and weight management programmes (some through third party partners at subsidised rates); preventative measures related to the member such as HIV, blood pressure and cholesterol tests; and regular exercise orientated activity such as gym, golf, walking and jogging (some in association with Vitality benefit partners). Points are awarded per event or activity being completed with different events being accorded different points awards[3]. Each tier other than blue has progressive entry criteria in terms of total number of points.

The higher the member's status, the greater the member's discounts and/or benefits at Vitality retail partners. For example, blue members receive a standard 20% off electronic goods bought from the Vitality online mall; bronze members receive 25% discount; silver 30% and gold 35%. It has been calculated that as a gold member on Vitality, it is possible to realise over R90 000 worth of savings by purchasing products and services through Vitality partners annually (Conradie, 2003:75). For a blue member, although to a lesser degree, the value is also significant, with the potential to save up to R30 000 per year.

Discovery uses a number of mediums to communicate with their customer base – their website, e-mail, postal mail, their branded magazine, customer call centre and SMS. The website is the primary medium of customer communication regarding the Vitality programme, with persuasive incentives to use the website and choose electronic methods for the delivery of Discovery orientated information. For example, by registering on the site as a new user and updating your personal details

[3] For a full list of activities and their awards please see Conradie's comprehensive report (2004(1):62-65 or the Discovery website www.discovery.co.za.

online, an individual is awarded a total of 5000 points[4]. To accumulate the same number of points by going to gym, a member would have to make 33 separate daily entries[5] at one of the gym partner companies. Points are also awarded for completing online surveys for health related issues such as general risk assessments, stress, and nutrition. Points are also awarded for administrative activities to members such as selecting the option of receiving statement and tracking claims via the website (Discovery, 2005).

The Discovery magazine is mailed to members on a quarterly basis with an issue dedicated to Vitality sent out at the end of each year (see Appendix C). It is published in association with one of their Vitality benefit partners Touchline Media and is mailed out to all Discovery policyholders. Discovery uses this glossy magazine as a communication tool to inform members of Discovery orientated information such as new procedures, benefits and products packaged with relevant health orientated content around fitness, nutrition and special interest areas like stress management.

### 5.5.3 Operational Overview

The Vitality programme operates through an integrated system of processes, technology and people both in their internal infrastructure and external environments. Vitality itself operates as a separate business to their insurance and administration businesses from an accounting and reporting perspective. Vitality has its own Managing Director, executive management team and is included in the annual report as a separate entity to its health and life businesses (Discovery, 2005).

From a customer experience perspective however, Vitality is an integrated aspect of interacting with the business. Discovery's customer contact centre is able to service all members through one telephone number, with requests diverted through to

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[4] 2500 points are awarded for registration as a first time user; 2500 points are awarded for updating personal details (Conradie, 2004(1):64).

[5] Points for gym attendance are awarded at 150 points per daily entry up to a maximum of 15 000 points per year (Ibid:62)

relevant departments for specialised assistance and requests. Policyholders are identified via their membership or policy number as a primary access point for verification and validation. Call centre personnel have access to each members profile and are able to access the majority of customer information through their systems over the phone. Vitality members are able to enquire about their status, points allocations, benefits applicable, book travel and purchase products from Vitality retail partners through the Discovery call centre. Although only 70% of policyholders are Vitality members, their entire range of non-insurance related benefits are only accessible by becoming a Vitality member (Conradie, 2004(1):67).

The most extensive format for Vitality orientated information is the Discovery website. Each member profile is accessible via a password controlled log-in. Thereafter the customer is given access to their full profile of Discovery products in force and details relevant to each product be it Health or Life policies or Discovery Card balances and online banking facilities, including detailed information regarding their Vitality status, progress and benefits (Discovery, 2005). Members are able to interact real-time in the completion of surveys, purchase of products through the on-line mall (where members Vitality status is automatically applied to discounts and pricing on products), read and in some cases even download a host of regularly updated content such as meal-plans and stress management programmes.

From an information gathering perspective, a number of Vitality orientated activities are dependent on the member proactively communicating with Discovery. With results of certain tests such as HIV; blood pressure; cholesterol; and vaccinations, if the amounts are not claimed via the member's core financial benefits which can be tracked centrally, the member is responsible for contacting Discovery. Once the member has provided Discovery with the required results, the points are allocated to the member's profile, subject to administrative waiting periods. In some cases even the tests are tracked, such as the Vitality fitness assessment which is carried out by

Vitality partners Body iQ, where a member is required to visit an accredited bio-kineticist and the incident of the test is reported to Discovery electronically.

With regard to the external environment, the Vitality programme has employed a number of tools to automatically track member behaviour and benefit utilisation. To access the gym, fitness and movie benefits, members are required to register for the benefit with the benefit provider independently of their registration with Discovery or Vitality. In the case of the gym benefit, the member is even required to activate their benefit with the Discovery call centre once the registration with the provider has taken place. Separate membership cards (magnetic stripe and smartcard depending on the partner) are issued to members, which are used for identification and tracking purposes. When a member makes use of a benefit, the incident is tracked through the partner systems and reported back to Discovery. With the launch of their Visa credit and debit card product, Vitality tracks card spend with Vitality retail partners and awards members with their monetary savings, relative to the partner itself and the member's Vitality status at the end of each month.

The health and lifestyle information analysis processes are not publicly available, but by inference, with member interaction with the Vitality programme, Discovery has an enormous amount of critical information at their disposal which in application could and seems to have had an impact on their strategic direction.

### 5.5.4 Strategic Overview

The fundamental principle of the programme is to incentivise their customer to become and remain healthy and to interact with the business as cost efficiently as possible. As a medical and life insurer, this approach is consistent with maintaining their commercial health and the key strategic thrust of a private listed company – profitability and in turn, return for their shareholders. The healthier their customer base, the less they claim. The less they claim, the greater the profit to be realised by the insurer. Discovery's 2003 annual report emphasises that:

> *"It is important to understand that Vitality's aim is not to reward loyalty, but to encourage healthy behaviour through powerful incentives"* (Conradie, 2004(1):61)

Although, the statement implies that Vitality is not aimed at rewarding a customer's loyalty to the business as is the statement of most other loyalty programmes, it does not mean that the programme does not intend to do so. What the Vitality programme does do, by incentivising healthy behaviour, is that it rewards members loyal to Discovery's strategic objective of profitability on their core risk-based products.

In further contradiction to their statement, cross-holding of Discovery products, a key indicator of customer loyalty, is incentivised via the Vitality programme. If a Vitality member has a health insurance policy as well as a life insurance policy they are automatically rewarded 5000 points, one month after the policy anniversary (Discovery, 2005; Conradie, 2004 (1):64). If a Vitality member has a life policy and selects additional products and benefits, they are awarded an additional 2500 points. Where a total 7500 points for increased core product spend and policy retention is equivalent to 50 trips to the gym or a comprehensive fitness assessment, the statement about Discovery's total focus on healthy behaviour and not rewarding customer loyalty is somewhat negated.

Where profitability is determined by increased revenues through the acquisition and retention of customer spend relative to the costs involved with serving the customer and the product purchased, the Vitality programme effectively supports strategic objectives. In terms of customer acquisition and retention, Vitality offers quantifiable value to their existing and prospective customers not only in terms of the discounted benefits but more importantly in the exclusive relationships that they have in place with their partners. The exclusivity of certain Vitality benefits that sometimes cannot even be matched by the partner's value proposition to their own customers, due to Vitality's subsidisation of certain products[6], is a key competitive advantage that Discovery holds over its competitors. Tracking tools such as membership cards which are required for identification and access to benefits assists them to manage utilisation in terms of cost and frequency. In the case of the gym benefit for example, the member is required to attend gym a certain number of times in a calendar year to avoid having to pay a reactivation fee therefore keeping subsidisation costs down while incentivising behaviour that contributes to Discovery's bottom line. The ability to gather and process information on utilisation of benefits allows Vitality to reach greater degrees of accuracy in the funding required to subsidise certain existing benefits as well as develop and launch new benefits. The application of the information limits the risks associated with utilisation and marketing expenditure, by providing decision makers with accurate, activity based statistics and reports.

Even in terms of their communication strategy, Discovery has cleverly used the mediums at their disposal to maximise their effectiveness in delivering on strategy. As a stand alone benefit or product of Discovery's business, the magazine directly relates to their stated purpose of healthier members, protecting and enhancing their lifestyles. By communicating detailed product and lifestyle information the magazine educates customers on how best to manage their health and the interaction with Discovery and in so doing, directly and indirectly, serving the customer by providing additional value and the business by reducing the customer's propensity to consume expensive resources such as insured benefits and policy administration.

### 5.5.5 Programme Performance

There is not much publicly available information on the performance of the Vitality programme itself. Figures available related to Vitality memberships seem to have remained somewhat constant over the last few years (Conradie, 2003, 2004(1);

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[6] Prices for benefits such as flights, car hire, accommodation, gym membership, movie tickets, electronics, airtime - see Conradie, 2004(1):65,66; Discovery, 2005

Discovery, 2005). With Vitality serving the business' core strategic objectives, certain inferences could be made by looking historically at their financial results as published on their website as well as a general analysis of the growth of the company and the products launched since the introduction of Vitality.

Some of Discovery's key financial indicators over the last five years of results are:

- Launch of Discovery Life (2000) and Discovery Card (2004)
- Growth in embedded value of the business of over 325%
- Growth in new business premium income of over 240%
- Vitality benefits expenditure has increased by 700%

(Source: Discovery, 2005)

Vitality results for published in the annual report 2004 are also positive:

- Operating profits up 52% to R50 million
- Growth in membership of 11% to 1 067 358 lives
- Six year record of 3.6 million years worth of health data for scientific research

In reference to Reichheld's focus on customer retention, Discovery has admitted to a lapse rate of 3.5%, the insurance industry measure for customer retention, the lowest in the industry indicating that the Vitality programme has led to loyalty as a 'by product' (Dugmore, 2005:11). Neville Koopowitz goes on to say that:

*"As people go up the Vitality levels, their lapse rates go down even further."* (Ibid)

Results and retention considered, it seems that the 'benevolent bribe' does work. As a parting statement and the validation of Vitality importance to Discovery business both in South Africa and abroad, Neville Koopowitz states in the 2004 annual report:

*"Discovery Vitality is an integral underpin to the Discovery business model...it acts as a unique enabler within each Discovery business"* (Discovery, 2005)

## 5.6 Dis-Chem Benefits

### 5.6.1 Company Overview

Dis-Chem is a South African pharmaceutical retail chain. It is a non-listed, family owned business founded in 1978 with one pharmacy in Mondeor, Johannesburg (Dis-Chem, 2005). Over the years Dis-Chem has grown progressively, particularly in the last four years, where the revenue is believed to have exceeded R 1 billion in 2004 with a network now consisting of 15 stores in Gauteng and 3 in the Western Cape (Conradie, 2005:85). 4 additional stores are expected to be opened around the country by the end of 2006 (Rosema, 2005).

One of the business' founder owners and current Managing Director, Ivan Saltzman, believes that Dis-Chem's exponential growth can be attributed to strong branding, a good product range that meet their customers' pharmaceutical, health and beauty needs, low prices and valuable customer relationships (Dis-Chem, 2005). Furthermore he believes that their competitive edge lies in first-to-market initiatives such as offering a loyalty programme in their market segment – Dis-Chem Benefits – launched in March 2003 (Conradie, 2005:85). Subsequently, larger retailer Clicks has moved aggressively into the pharmaceutical retail space and with it their Clubcard programme the name of which denotes very similar characteristics to Tesco's Clubcard in its function and operation(Conradie, 2004(3):58, 59).

Dis-Chem corporate motto is:

"*...take care of the customer and the business will take care of us...*" (Dis-Chem, 2005)

According to Trisch Rosema, Dis-Chem's current Business Relationship Manager, the Benefits programme was introduced to support the business' motto above in rewarding customers for their loyal spend. Dis-Chem Benefits took that concept one step further by rewarding customer chosen communities on behalf of their customers at the same time (Rosema, 2005). In Ivan Saltzman words:

*"Dis-Chem stores have established themselves as a 'destination store' offering customers a myriad of competitively priced products for all their health and beauty needs. Our Benefits Programme is set to further enhance our offering to customers by giving them more value for money, while supporting our communities."* (Dischem, 2005)

### 5.6.2 Functional Overview

Dis-Chem Benefits shares a number of similarities with the Tesco Clubcard. One notable difference is the integration of 5 pre-selected community based organisations or charities – CHOC, POWA, My School, Selwyn Segal Home and Meals on Wheels – as integrated beneficiaries of the programme in the sense that they receive portions of the rewards generated by customer spend (Dis-Chem, 2005).

Customers are able to register for the programme at any Dis-Chem store at no cost. At point of registration they are requested for their personal details such as contact information, demographics (including birthday, marital status, gender, occupation), Dis-Chem relevant information (product interest, prescriptions) their chosen community organisation as well as their special interests in terms of their health e.g. diabetes, cholesterol, asthma (See Appendix A). With the completion of the registration form, the customer is issued with a plastic card with a magnetic strip. In order to accrue rewards, customers are required to present their card at point of purchase, in addition to their method of payment. With each transaction, the Benefits card is then swiped through the point of sale device and 2% of spend is given back to the customer in the form of points, split into two categories – 1.5% goes to the customer and the remaining 0.5% is accrued to the community organisation as per the customer choice at registration. Recent developments have included batch (e.g. 1000 points when purchasing a certain product or completing surveys), double and triple points promotions, in association with product suppliers (Rosema, 2005).

Points balances are communicated every month to each cardholder via SMS and email, as per customer registered request, including notifications of Rand based amounts paid to their chosen charity thanking them for their support (Conradie, 2005:87). Cardholders need to accumulate 675 points in order to redeem a reward, where 1 point is the equivalent to R0.01 in monetary value, therefore 675 points gives the customer R6.75 to spend. Once the threshold is reached cardholders are able to spend their points only within any Dis-Chem store on any product at any time. Points are awarded on all purchases, subject to additional promotions, but exclude prescription medicines due to recent regulatory cuts on margins on such products (Rosema, 2005). In terms of additional customer benefits, Benefits members are entitled to a free quarterly magazine, available in each store, which contains health and special interest relevant information, promotions and Dis-Chem news (See Appendix B).

One recent development was the launch of Dis-Chem's first special segment sub-programme for senior citizens over the age of 60 years called '60Plus'. The customer base on this programme has grown to 20 000 members in the last 8 months, most of which are new members to the Benefits customer base (Rosema, 2005). The differentiated benefit to this base is regular double points promotions on purchase.

### 5.6.3 Operational Overview

The Benefits programme, similar to the Clubcard programme is systems intensive. Aside from the customer responsibility of having the card present for point accrual at point of purchase, the programme has been carefully integrated into the business' customer and transactions processing.

When the Benefits card is swiped through the point of sale device at the till point, the centrally stored customer information related to that card is able to be matched with the method of payment, time and date of purchase and the items purchased. This is made possible through the integration of the POS system, their information and transaction switching system developed by a company called CKS, run by Traderoot and the centralised Benefits customer and rewards database which is housed in a treasury system developed by a business called RMS (Conradie, 2005:87). Costs of the programme are contained by keeping it store orientated. As with the systems, all Benefits orientated activity is centred around the store network, including the distribution of the Benefits magazine. Communication with members is also kept cost efficient with the use of SMS and email communication instead of the traditional postal mail route (Ibid:87).

The programme is supported in store by one or two employees per store, known as Customer Consultants, who are trained to assist Benefits members, both prospective and existing with registration and information (Rosema, 2005). Each Dis-Chem cashier is trained to ask for the Benefits card as the opening statement to any customer purchase processed.

### 5.6.4 Strategic Overview

Although Dis-Chem do not openly admit to the strategic value of the Benefits programme, the implications for the information and intelligence that they have access to, considering a comparative assumption with Tesco's Clubcard, is immense.

By being able to match their cardholder profiles to purchases, they have in their power the same quality of intelligence that the Clubcard programme offers Tesco. In an interview with Dis-Chem's Trisch Rosema (2005), she was insistent that the programme's primary purpose was not revenue orientated, but more geared towards community orientation and as a reward for customer loyalty. These intentions are admirable but whether or not Dis-Chem actually applies the information they have access to in their business at present, the value of that information is undeniable.

There are examples where the information is being used by a business to better serve their customers in line with their company motto and strategy. Special interest information is now being analysed in order to provide relevant information and market products to customers who have expressed their interest on a certain topic such as diabetes or asthma (Rosema, 2005). This information is due to be distributed via email newsletters which have a greater ability to be cost-efficiently customised.

Rosema did confirm that product information collected through the programme has been used to see how far some customers travel to shop at Dis-Chem and in some instances information is shared with suppliers for the purposes of tracking promotions per store. By implication, any purchase can be analysed against the customer profile provided by the cardholder and the insight derived from that could easily be translated into information to assist strategic decision making. Such intelligence would allow Dischem to understand their market to such an intimate degree that they would know what products sold in what stores, at what times, to what type of customer. They would be in a position to know how far customers travel from their residence to make a purchase. Equipped with that type and extent of information, executive management would be able to make well-informed decisions about inventory control, marketing and promotion efficacy, customer tastes and trends and even extrapolations on where new stores should be opened.

### 5.6.5 Programme Performance

With a membership base which has grown from 90 000 by 2003/2004 to a present membership base in excess of 350 000[7] cardholders, the success of the programme as a customer information gathering project is unquestionable.

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[7] Conradie, 2003:28; 2005:85.

The Dis-Chem website stated statistic mentions that R1 644 410.80 had been contributed to three of their 5 community based partners indicating that the amount is fairly dated, probably up to the time it was published on their site which seems to be some stage during 2004 (Dischem, 2005). As a rudimentary calculation, that amount as 0.5% of spend translates to revenues of over R 300 million[8] which is a fairly sizable portion of revenue tracked via the Benefits programme. Another figure published on their website includes a statement, dated around the April 2005, that Benefits members had contributed over R 3 million since inception (just over 2 years) to one of the beneficiary charities, CHOC (Dischem, 2005). That amount, which is the total contribution to 1 of the 5 community organisations on the programme, translates into R 600 million worth of tracked customer spend. Rosema added further support to this correlation in stating that between 60% - 70% of transactions in Dis-Chem stores are related to a Benefits card. The programme's structure denotes a primary intention to incentivise and support customer's frequency of purchase i.e. the more you spend the more points you will accumulate – similar to the Tesco Clubcard. In support of this contention, Rosema stated that in one board report, average spend by loyalty members was more than 40% higher than customers who were not loyalty members.

Some further interesting facts and anecdotes that Rosema mentioned were derived from the information generated by the Benefits programme include:

- Average usage (transaction) of Benefits card is 1 visit per week
- 72% of Benefits cards are held by women
- 6 new stores were opened in 2004 signifying a 50% growth in store network

In terms of the programme's future and developments, Dis-Chem is understandably reserved about the details. The programme is due to be re-branded in the near future

[8] Refer to section 5.6.2: Basic equation: Contribution x 200 = Revenue (Where community contribution is = 0.5% of spend)

in conjunction with the launch of two new Benefits orientated initiatives in September and November 2005 (Rosema, 2005). When questioned whether the programme is due to extend the functionality of the Benefits card towards it becoming an integrated payment mechanism in line with the developments with the Tesco Clubcard and the Discovery Visa Card, Rosema's response was 'no comment'.

In conclusion, there is nothing definitive from Dis-Chem material, either in text or through the interview held, to confirm that they consider Benefits as an integral part of their business. Looking at the performance of the programme however, and the exponential growth of their store network, healthy revenues and customer insights, it is self evident that the programme has made a significant contribution to the business and their value proposition to customers. With the unique aspect of automated charity contribution, Dis-Chem have effectively integrated an emotional hook into the rational motivation of being rewarded for loyal spend. This is a clear differentiator and tool of competitive advantage over their competitors and other loyalty programmes. In terms of achieving business benefits, the programme has taken care of its customer and their communities.

### 5.7 Summary Findings

Common features relative to the performance of programmes in these studies describe loyalty programmes founded on the gathering, processing and application of customer information. When information is extracted and matched to the customer, this offers the business a warehouse of derived business intelligence which can be translated into value through knowledge creation and more accurate decision making. In their application, information driven loyalty programmes allow the business to enhance its ability to create a loyal customer base by rewarding profitable behaviour by 'knowing' their needs and expectations. With the application of the knowledge generated, the business has a higher propensity for growth, by knowing how to serve the needs of the source of their revenue in wider, deeper ways.

Loyalty programmes can however elicit various degrees of success in delivering on the ultimate objective of creating, stimulating and maintaining loyalty from customers. At their worst they have shown no return on investment and in certain circumstances proved costly, damaging the business' brand, reputation, revenue and strategic direction (Humby et al, 2003:11-13).

As per the case studies presented, successful programmes are those that understand the dynamics of a complex system based on relationships, recognising the synergy of customer and business objectives for the mutual benefit of both parties committed to the long term. These information-driven models of systematised loyalty stand as a testament to the paradigm of loyalty economics and the purpose and performance of loyalty programmes. On analysis, loyalty programmes that are technologically enabled, customer focused, information systems are able to offer business a platform for value creation, innovation and sustainable competitive advantage.

# CHAPTER 6: LOYALTY AND STRATEGY

## 6.1 Introduction

This chapter will extract the common components derived from the analysis of the loyalty programmes selected as case studies as well as the preceding theoretical discussions to provide the foundations for a loyalty-orientated strategic framework and illustrate how information can be translated into value. Key outputs of the paper in terms of their strategic implications, operational requirements and functional purpose in achieving business objectives will be analysed to determine their generic strategic value and application. These findings will be synthesised with key concepts and existing models developed from the theoretical discussions of information, knowledge, loyalty and customer centricity to ensure the argument's conceptual cohesiveness and coherence.

In the discussion of the functional purpose of such a strategy, core concepts regarding stakeholders in the business system, the links connecting them and value generated through their relationships will be presented. From the operational perspective, elements that provide the business with the ability to identify, manage and measure the customer relationship and their loyalty will be filtered to present the systems requirements for a loyalty strategy.

In the strategic application, a conceptual and systemic framework will be presented that will integrate the various concepts of argument into a model to offer a new perspective on the traditional and virtual value chain models. The new model will take into consideration the power of the customer, information and knowledge as strategic resources. It furthermore recognises the flow of value in a system of economic relationships and aims to deconstruct the business system in order to highlight and mobilise the creation, development and retention of value within it.

### 6.2 Functional Purpose

A loyalty strategy should be constructed with the specific aim that its activation will assist in the achievement of the business' objectives such as profitability, productivity, growth and innovation. Such a strategy should recognise that **value** is the product of the interactions and exchanges between the various **stakeholders** within the business system. The two primary stakeholders are the customer and the business. Key to the creation of value therefore, is the **relationship** between the **customer**, the **business** and its extended value chain (consisting of **employees, partners** and **investors**). The common link to understanding their nature and conditions of the relationships themselves is the **information** regarding the stakeholders themselves and how those profiles relate to information generated through their interactions and exchanges.

Where value through the exchange between the stakeholders is **quantified** and recorded usually in monetary terms, it is **qualified** through the analysis of information regarding the exchange and the stakeholders involved with it. The qualification of the relationship provides the business with ability to generate **knowledge** and, when applied, realise the full **value of information**, summarised by Marchand (2000(3):296), to:

- Add value to relationships with all stakeholders, especially customers
- Manage internal and external environmental risks
- Reduce the costs of exchange and interaction
- Drive innovation in product, service and strategic areas

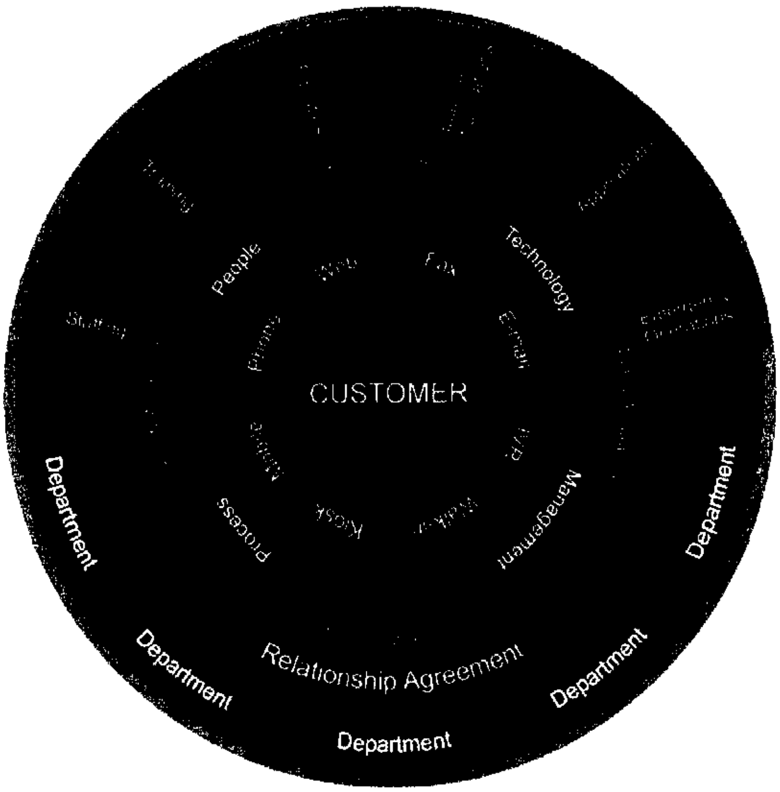
Central to the value of information is to identify their sources in the internal and external environments. These sources may be past, existing and potential. The **audit of the sources and the information flows** that bind them together will provide the business with a map of their links in their **knowledge landscape**. Once these **links** have been identified, attention should be given on how to manage them with particular emphasis on ensuring the quality and quantity of information derived from them. Special care needs to be taken regarding looking at the **management of information** too mechanistically. Although information flows can be identified and systemised in some way, the sources of that information (human agents) have a tendency to **change** its **frequency** and **content** subject to their complex sets of **motivators**. In this collective environment, an **adaptive strategic system** would be advised, to take the **personal, situational, cultural, political and societal factors** that pervade the behaviour of humans and their informational value.

### 6.3 Operational Requirements

In order to put the purpose into practice, a number of operational aspects are required. Once the sources of information have been mapped the next stage is to support, track and measure the flows of information between these sources through designing and implementing appropriate **information systems**. Particular attention needs to be given to the business' Information Orientation (in line with Marchand and Earl's strategic frameworks which prescribe the **integration** of the business' IT, IS, IR and IM practices) to extract maximum value out of their internal and external environments to foster **knowledge creation** and assist in **decision making**.

One approach to track and extract information from the external environment and assess its impact on the business is to implement a **Competitive Intelligence** (CI) system. CI implies a process of **information collection, processing and analysis** that looks further than just the competitors (Cook & Cook, 2000:14). It implies a shift of focus from the competitor as an object, to a focus on what makes the subject – the business – competitive. CI is an information system that in practice becomes the business' **actionable, disciplined awareness** of the total environment.

A key requirement for any IS is its ability to integrate the business's flows of information. The model below illustrates such an IS, where the **customer is central** to the **business system**. The primary layer of integration needs to take place at the point of contact with the customer i.e. at the point where the business communicates with the customer and vice versa. The various channels need to be identified in order to effectively integrate the business' **people, processes and technology** in serving the customer, with the business' infrastructure and resources complementing the system:




Source: Assabi, 2004

**Figure 6.1: The Customer Centric Model**

To ensure the flows between the business and its customers, it is imperative that the business understands the **reason and conditions of the relationship** with the customer. By identifying the **motivators**, the business is able to understand the primary reason of the relationships existence and support these motivations by meeting and exceeding the customer's **expectations**. With the understanding of the terms of the relationship, the business is in a position itself to **target, acquire, manage and retain** those relationships. In addition, business will also be in a position to understand their customer's interactions and exchanges in reference to their own measures of **profitability** and **productivity**. By discovering why and how customers behave, the business is able to guide the customer to more profitable **patterns of behaviour**, inducing such behaviour through appropriate and relevant **incentives**.

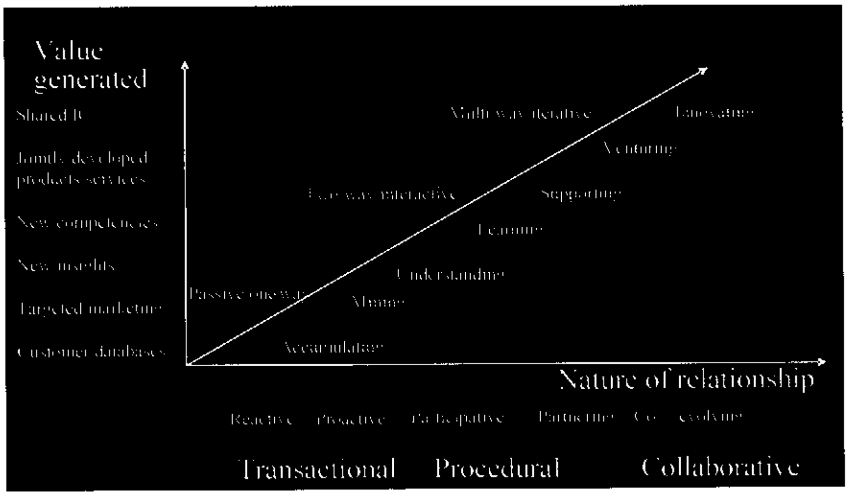
By decoding the mutual motivators of the relationship through analysing personal, transactional, interactive or market related information, the business is able to **influence** the outcome of the relationship. In practice, the deconstruction of the relationship allows the business to place **measures** on it. With the right systems, measures and tools such as CVA, ROC and LTV, the business has the ability to analyse the value of their customers, right down to the individual if required. Furthermore, these measures are able to assess the performance of the relationship, track the mutual **commitment** and tenure to the relationship, by definition quantifying the customer's **loyalty**.

These measures provide the business the ability to justify the paradigm of customer centricity and loyalty and assess the success of a loyalty strategy against true **business performance** indicators. As a caveat to the exploitation of customer information, **ethical** and **legal** guidelines and policies need to be considered by referring to local and international regulations and professional instruments.

### 6.4 Strategic Application

In terms of the measurability of a loyalty strategy's application, Amidon's **customer relationship spectrum model** below provides a structure against which the value generated and the development of relationships between the business and its customers can be evaluated.

If the ultimate purpose of the strategy is the creation of knowledge for **sustainable competitive advantage**, the business could consider its entire complement of stakeholders as customers in the process of innovation.




Source: Amidon (1997) in Skyrme, 1999:218

**Figure 6.2: The Customer Relationship Spectrum**

A full spectrum of stakeholders would include those involved in the business primary value chain but would also be extended further to include the **market**, wider **society** and the **environment**. These extended links and flows hold further value as motivators and sources of information. As the relationship with each stakeholder develops, the nature of each relationship can be charted against the value generated as it evolves. The progress and success of the loyalty strategy can be measured by classifying the stage of each stakeholder relationship as per the stages of the model.

In the new economy, a mechanistic approach to strategy based on a set, structured approach will lack the **flexibility** required to accommodate and adapt to the flux and flow of the complexities of an environment driven by valuable relationships and informational links between partners. Huffman (2002) recognises that a successful strategy is determined by **intuitive skills** acquired through practical **experience** rather than theoretical application. A successful loyalty strategy for a business will therefore need to be ultimately driven by a **leadership** with the understanding and experience of the flows and usage of knowledge, supported by a **culture of continuous awareness**, responsive to the business' holistic environment.

## 6.5 The Virtuous Value Chain

In response to these conclusions, the derived model below is a development on the traditional and virtual value chain models. It is a convergence of the flows of information between their sources, and the revolving value of relationships in the business system. In consideration of the factors discussed above, the model is a deconstruction of the business system in the context of the customer, information and the paradigm of loyalty economics. In reference to the value chain illustrations presented in Chapter 3, the inclusion of the customer and the value of the information generated through its management and application (which could be taken in the broadest sense as discussed in section 6.4) shows how the value chain becomes bi-directional and a cyclical system. It is called the 'Virtuous Value Chain'.

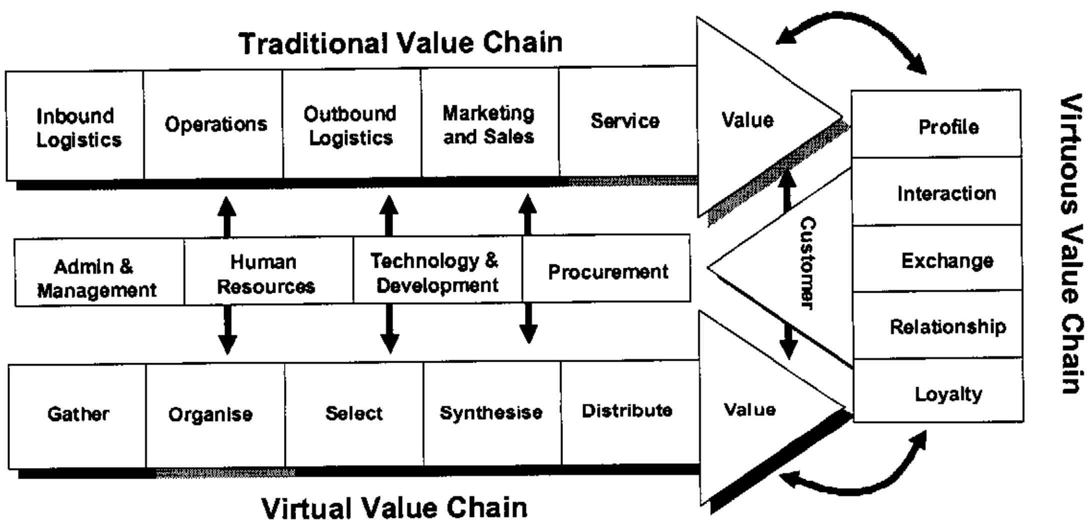



**Figure 6.3: The Virtuous Value Chain - Linear View**

Figure 6.4 below is a delineated illustration of the business system. Its shows the information (and knowledge) links between the four key stakeholders namely the: business, customer, partner and employee. In certain circumstances those links maybe indirect or may not exist at all depending on the circumstance hence the checked link between some of the stakeholders. The links indicate bi-directional flows of information, which bind the respective relationships, with examples of resultant value from such relationships detailed with the direction of the flow.

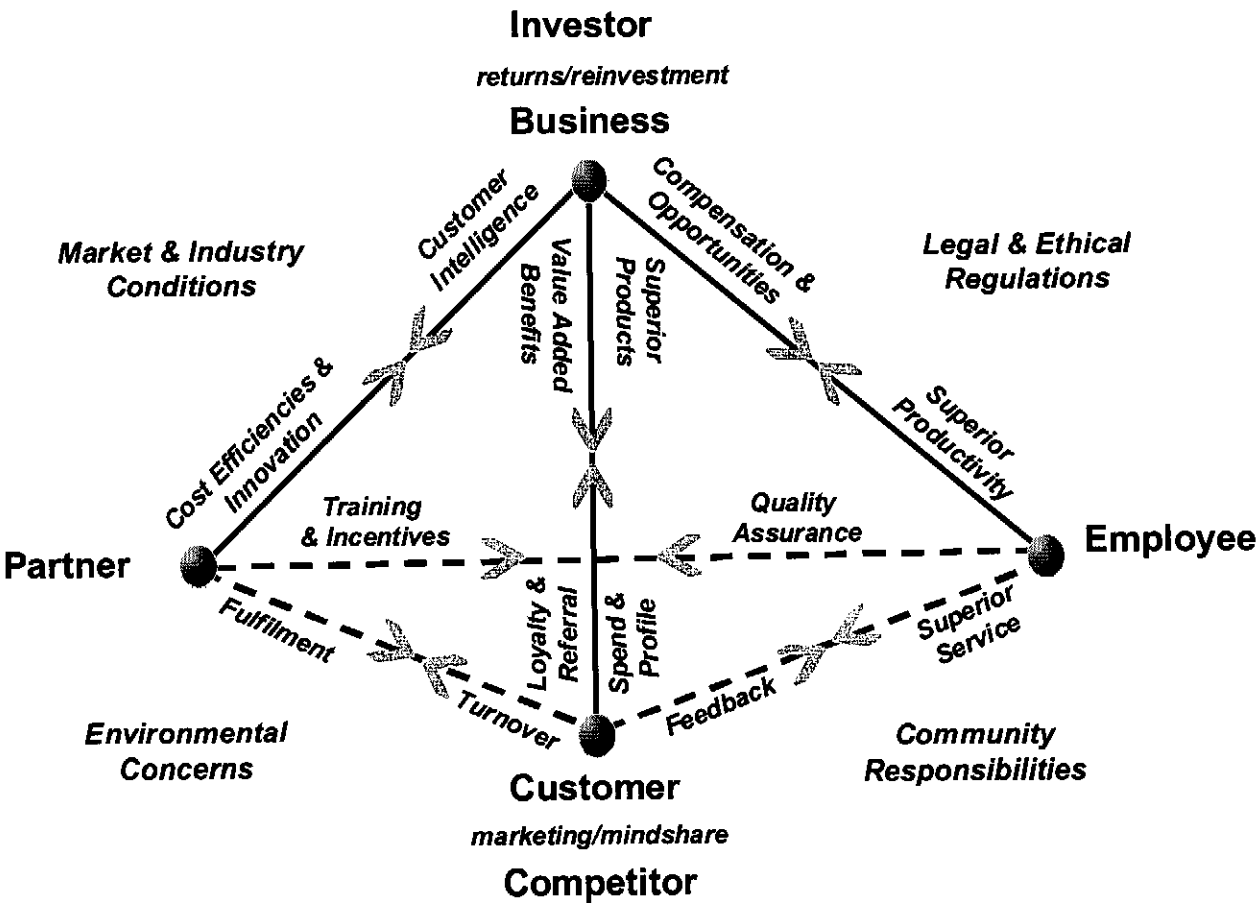



**Figure 6.4: The Virtuous Value Chain – Systemic View**

The systemic illustration also takes into account the links, demands and value flow of investors with the business, as well as the relationship of competitors with a business' customers (which in application is repeated with the competitor's business should that customer be promiscuous or defect). The other factors included denote important external influences that need to be considered in maximising the tenure and flow of value between the stakeholders in the system.

In theory and practice, the model(s) aim to provide a business with a referential structure for the creation of a strategic platform or 'loyalty programme' to integrate and manage the various factors found in a business system. By remaining aware and flexible to changes to the flows and sources of value, structured initiatives in the form of loyalty programmes can become credible platforms of value creation.

# CHAPTER 7: THE SCIENCE OF MARKETING

## Concluding Remarks

There is evidence from various case studies that a focus on the principles of loyalty provide a business with the improved ability to translate the information at their disposal into value. By understanding their customers and their needs by gathering, processing and application of transactional, interactive and demographic data, the business gives itself the opportunity to maximise the relationships with all the stakeholders in the system and in some cases, such as Dis-Chem's charitable beneficiary programme, generate additional value in the external environment. The information oriented approach to the management of customer relationships allows the business to reduce the level of guessing and through tracked performance makes the discipline and decision-making of marketing more scientific than ever before.

It is the contention of this paper therefore, that successful applications of loyalty and loyalty programmes that are founded on information and the analysis and application of learning outcomes from such information, offer businesses a key to understanding their environments and their relative position in the market through the eyes of their customer and their extended value chain. In so doing, businesses are able to redefine the way they do business by knowing how to meet the changing demands and needs of their customers, securing business survival and growth in the future. The model of the Virtuous Value Chain is an illustration of a value driven business system, a platform created on the premise of relationships and the power of information, where loyalty between its constituents becomes a mutually beneficial requirement to realise maximum returns.

In application, the model could act as a strategic tool aimed at illustrating how loyalty programmes as business systems should focus on supporting the relationship between a business and its customers in order to derive value from that customer over the long term. Particular emphasis needs to be made on the necessity for adequate and flexible information systems, measures, tools and resources to translate the wealth of information into the true wealth of value. By moving towards the measurability that an information oriented approach to business systems demands, the social nature of business becomes more scientific in nature. Being able to quantify the relationship between the customer and the business in a more measurable way, the financial and marketing functions within an organisation are finally able to ascribe to a common set of business objectives, and relate to each other effectively. An information oriented model offers the business the ability to structure its measurement and decision making regarding marketing strategies and initiatives on a more scientific basis.

In further study, this model is intended to be applied to the business environment to test and refine its reliability and validity. The further aim of such an investigation would be to derive a practical toolkit to assist in the evaluation of business systems, in reference to the Virtuous Value Chain. With the primary purpose of the model to illustrate the convergence between the business and its objectives, the customer and their needs and the market in which they interact, it could also be applied in the creation, evaluation and development of loyalty programmes.

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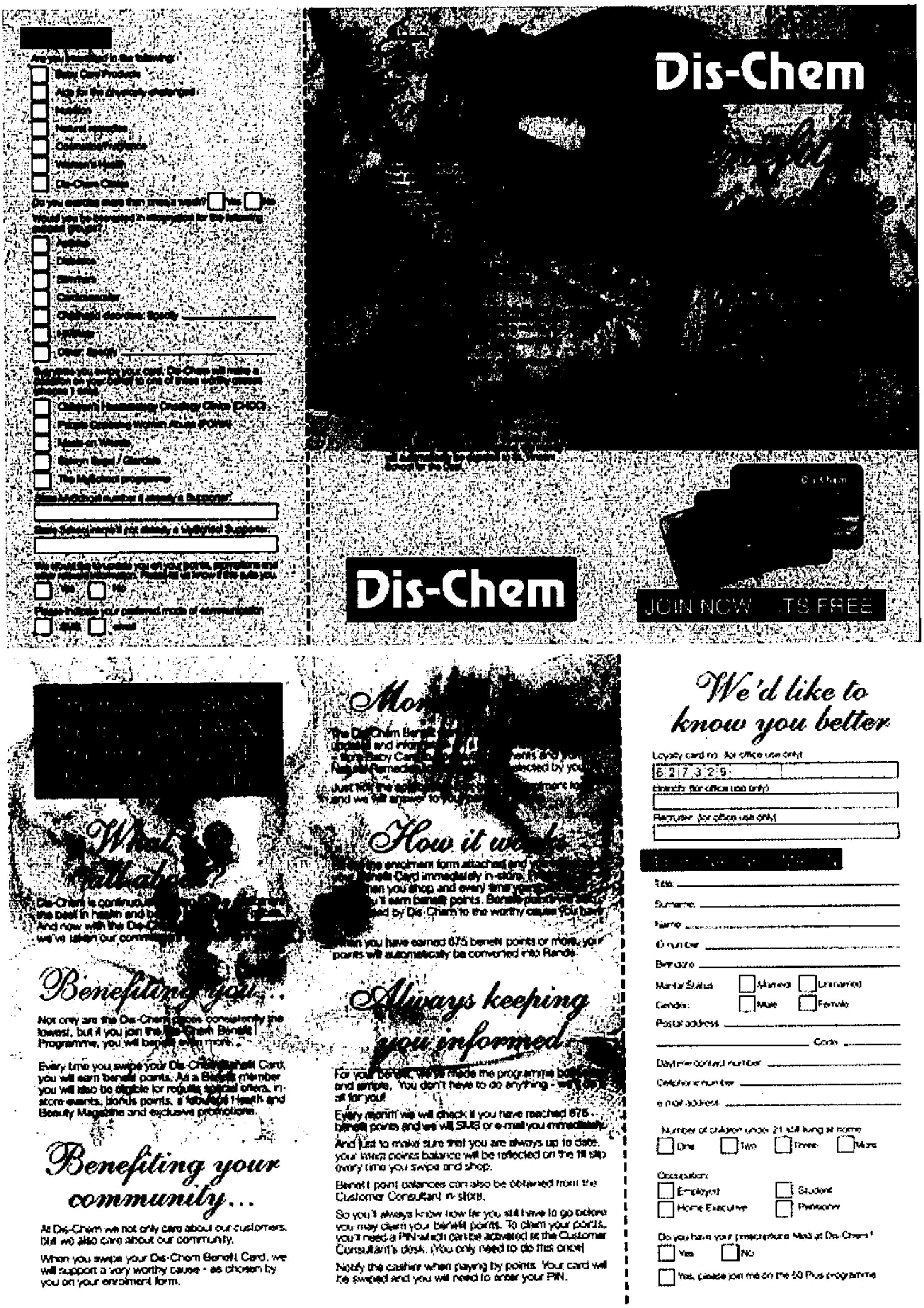
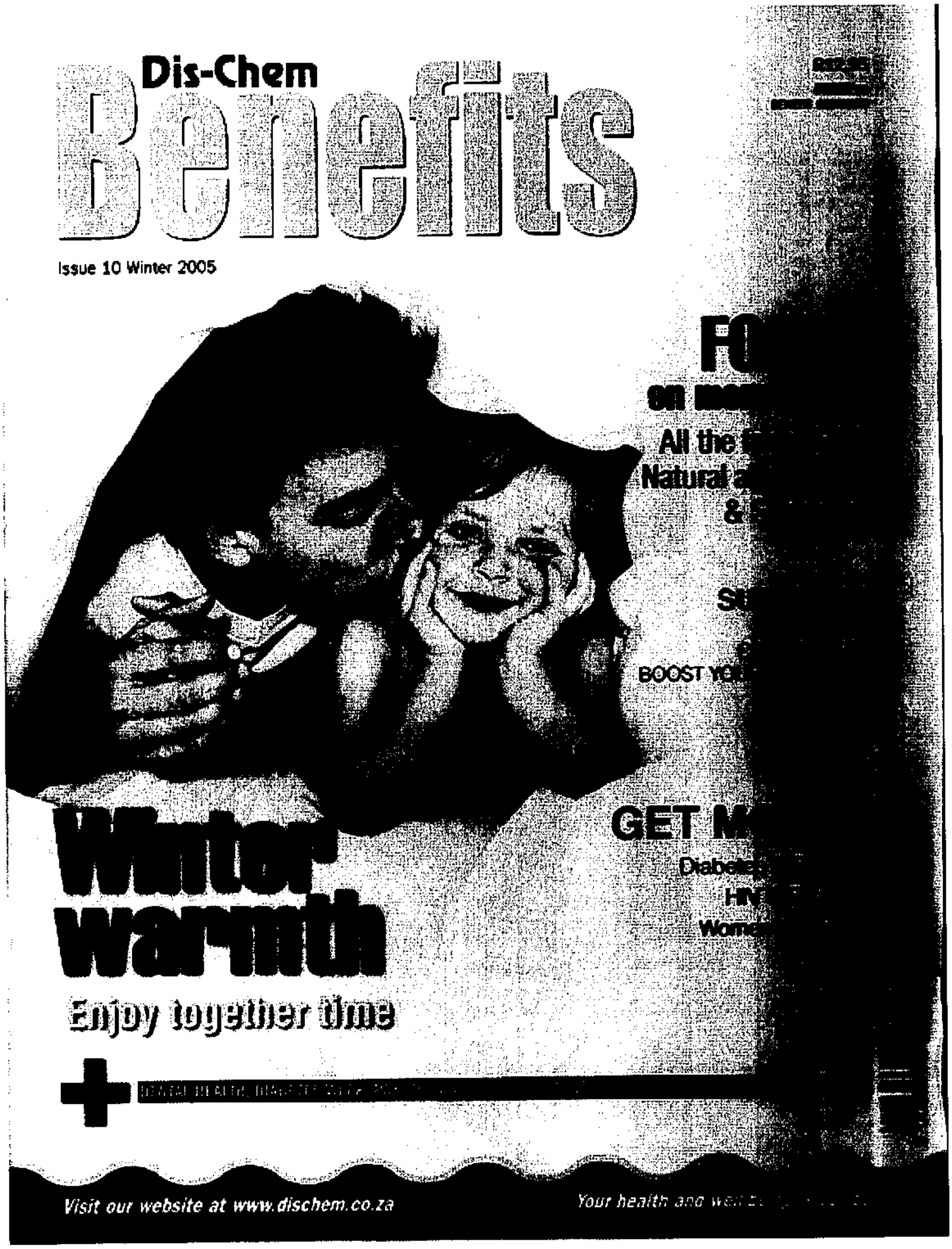
# APPENDICES

## Appendix A: Dis-Chem Benefit Programme Registration Form



## Appendix B: Dischem Benefits Magazine Cover



## Appendix C: Discovery Magazine Cover